No. 91-794-CSX
Status: GRANTED

Title: Henry Harper, et al., Petitioners
v.
Virginia Department of Taxation

Docketed:
November 15, 1991

Court: Supreme Court of Virginia

Counsel for petitioner: Kator,Michael J.

Vide:
91-882

Counsel for respondent: Terry,Mary Sue, Marshall,Gail Starling

Entry	Date	Note	Proceedings and Orders
1	Nov 15 1991	G	Petition for writ of certiorari filed.
5	Dec 16 1991		Brief amici curiae of Arizona and Wisconsin State Federations of NARFE filed.
2	Dec 18 1991		Brief of respondent VA Dept. of Taxation in opposition filed.
3	Dec 20 1991	D	Motion of petitioner to expedite consideration of the petition for a writ of certiorari filed.
4	Dec 31 1991		DISTRIBUTED. January 17, 1992
6	Jan 13 1992		Motion of petitioner to expedite consideration of the petition for a writ of certiorari DENIED.
8	Apr 27 1992		REDISTRIBUTED. May 15, 1992
9	May 18 1992		Petition GRANTED.
			**********
10	Jun 1 1992		The order entered May 18, 1992 is amended to read as follows: The petition for a writ of certiorari is granted limited to Question 1 presented by the petition.
11	Jun 8 1992		Record filed.
		*	Original proceedings Circuit Court of City of Alexandria, Virginia (2 folders)
12	Jun 15 1992		Record filed.
		*	Partial proceedings and briefs Supreme Court of Virginia.
14	Jun 16 1992		Order extending time to file brief of petitioner on the merits until July 17, 1992.
15	Jul 2 1992		Joint appendix filed.
16	Jul 16 1992		Brief amicus curiae of The Military Coalition filed.
21	Jul 16 1992		Brief amicus curiae of James B. Beam Distilling Col filed.
17	Jul 17 1992		Brief of petitioners Henry Harper, et al. filed.
18	Jul 17 1992		Brief amici curiae of Designated Federal Retirees in Kansas, et al. filed.
20	Jul 23 1992		Order extending time to file brief of respondent on the merits until September 8, 1992.
22	Aug 12 1992	D	Motion of Tax Executives Institute, Inc. for leave to file a brief as amicus curiae filed.
23	Aug 19 1992	N	Motion of respondent to strike the amicus curiae brief of Tax Executives Institute, Inc. filed.
24	Aug 25 1992		Opposition of Tax Executives Institute, Inc., as amicus curiae, to motion of respondent to strike the amicus curiae brief of Tax Executives filed.
25	Sep 4 1992		Brief amicus curiae of Georgia filed.
26	Sep 4 1992		Brief amici curiae of Utah, et al. filed.
29	Sep 4 1992		Brief amicus curiae of Arkansas filed. VIDED.

No. 91-794-CSX

Entry	Date	Note	Proceedings and Orders
27	Sep 8 1992		Brief amici curiae of Virginia Manufacturers Association, et al. filed.
28	Sep 8 1992		Brief amici curiae of National Governors'Association, et al. filed.
30	Sep 8 1992		Brief of respondent Virginia Department of Taxation filed.
31	Sep 8 1992		Brief amicus curiae of City of New York filed.
32	Sep 8 1992		Brief amici curiae of North Carolina and Arizona filed.
33	Sep 28 1992	D	Application (A92-267) for extension of time to file reply brief on the merits from October 13, 1992 to October 23, 1992, submitted to The Chief Justice.
35	Sep 29 1992		Application (A92-267) denied by the Chief Justice.
34	Oct 5 1992		Motion of Tax Executives Institute, Inc. for leave to file a brief as amicus curiae DENIED.
36	Oct 13 1992		SET FOR ARGUMENT WEDNESDAY, DECEMBER 2, 1992. (1ST CASE)
38	Oct 14 1992		Reply brief of petitioners filed.
37	Oct 15 1992		CIRCULATED.
39	Dec 2 1992		ARGUED.
40	Dec 2 1992		Letter from counsel for the petitioner received and distributed.

91-794

No. ——

Supreme Court, U.S.
FILED
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OFFICE OF THE CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

Petition for a Writ of Certiorari to the Supreme Court of Virginia

---

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. Whether this Court's decision in *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

2. Whether the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111 prohibit a state from taxing pensions of military retirees while exempting from taxation the pensions of its own retired employees.

PARTIES TO THE PROCEEDING

Petitioners are 420 civil service and Armed Forces retirees (predominantly members of the Virginia Federation of Chapters of the National Association of Retired Federal Employees and the Military Retirees Taxpayers Association) who have paid state income tax on their federal annuities to the Commonwealth of Virginia. A list of the individual petitioners appears as Appendix E at 22a.

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IN THE

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OCTOBER TERM, 1991

No. ——

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

Petition for a Writ of Certiorari to the Supreme Court of Virginia

---

PETITION FOR A WRIT OF CERTIORARI

Henry Harper and 420 named federal civil service and military retirees[1] hereby petition this Court for a writ of certiorari to the Supreme Court of Virginia.

OPINIONS BELOW

The opinion of the Supreme Court of Virginia (App. A at 1a-5a) is as yet unreported. This Court's order remanding this matter to the Supreme Court of Virginia (No. 90-1685, June 20, 1991, App. B at 6a) is reported at 111 S.Ct. 2883. The prior decision of the Supreme Court of Virginia (App. C at 7a-17a) is reported at 401 S.E.2d 868. The decision of the trial court, the Circuit Court for the City of Alexandria (App. D at 18a-21a) is unpublished.

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[1] A list of all individual petitioners is attached as Appendix E.

JURISDICTION

The Supreme Court of Virginia issued its opinion on remand from this Court affirming its denial of petitioners' entitlement to tax refunds on November 8, 1991. This petition is, accordingly, filed within the time allowed by law. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

STATEMENT

In *Harper* v. *Virginia Department of Taxation*, U.S. No. 90-1685, this Court vacated and remanded the decision of the court below refusing to grant petitioners tax refunds upon prospective only application of *Davis* v. *Michigan Department of Treasury*, 489 U.S. 803 (1989). The Court directed that the Virginia Supreme Court reconsider its decision in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). After reconsideration in light of *Beam*, the court below affirmed its prior decision in all respects. Petitioners submit this second petition for certiorari seeking to reverse the Supreme Court of Virginia's erroneous denial of their entitlement to refunds of taxes collected in violation of 4 U.S.C. § 111 and the Supremacy Clause of the Constitution.

REASONS FOR GRANTING THE PETITION

This petition presents questions of substantial public importance concerning the propriety of states retaining taxes imposed in violation of the Constitution of the United States. This case arises as a sequel to this Court's remand order last Term in *Harper v. Virginia Department of Taxation*, No. 90-1685, 111 S.Ct. 2883 (1991). It presents the specific question whether this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), may be applied purely prospectively so as to deny tax refunds to federal retirees.

Prior to *Davis*, over twenty states employed income tax schemes that discriminated against federal retirees and in favor of retirees of state and local governments. Today, litigation continues in all but four of those states, and, in virtually all these cases the principal defense against payment of refunds is nonretroactive "application" of *Davis*. Notwithstanding this Court's decision last Term in *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2338 (1991), and the remand orders in *Harper* and *Bass v. South Carolina*, 111 S.Ct. 2881 (1991), states continue to argue, and lower courts continue to hold, that *Davis* is not entitled to retroactive effect. Review by this Court is necessary to resolve finally the issue of the retroactivity of *Davis* and to stem the flow of confused misapplications of *Beam* in other contexts.

1. After this Court's decision in *Davis*, refund actions were initiated in all the states that had employed a discriminatory tax scheme similar to that employed by Michigan. To date, only four of those states have finally resolved these claims and begun paying refunds. First, in *Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. banc. 1989), *cert. denied*, 110 S.Ct. 718 (1990), the Missouri Supreme Court declared that refunds were required as a matter of state law. After this Court's decisions in *McKesson v. Division of Alcoholic Beverages and Control*, 110 S.Ct. 2238 (1990), and *American Trucking Ass'ns v. Smith*, 110 S.Ct. 2323 (1990), the State of New Mexico declined to appeal a trial court's finding of refund liability. *See Burns v. New Mexico*, No. SF 89-1314(c) (1st Jud. Dist. Santa Fe County, April 5, 1990). Michigan has begun paying refunds and, most recently, West Virginia has ordered the payment of refunds to federal civil service retirees. *See In Re Schirck*, No. 90-5201 RPD (Tax Comm'r of W. Va. Sept. 23, 1991).

Litigation in other states is ongoing. Reargument was heard in *Bass v. South Carolina* on October 30, 1991. In *Swanson v. North Carolina*, 407 S.E.2d 791 (N.C. 1991), *pet'n for reh'g pending*, a sharply divided court applied

Chevron[2] (notwithstanding *Beam*) to deny refunds. In Arkansas and Colorado, the state supreme courts held that refunds were due. *See Pledger v. Bosnick*, 811 S.W.2d 286 (Ark. 1991), *pet'n for cert. pend'g*, No. 91-375; *Kuhn v. Colorado*, 817 P.2d 101 (Colo. 1991). However, in neither state have refunds been paid: Arkansas' petition for certiorari is pending and the time for Colorado to file its petition has not yet expired.

On November 14, 1991, the Supreme Court of Montana affirmed the denial of refunds to federal retirees. *Sheehy v. Montana*, No. 90-540 (Mont. Nov. 14, 1991). In Oklahoma, Mississippi, and Utah, refund claims are pending on the merits in the state supreme courts.[3] In other states, refund claims are pending in intermediate state courts of appeals or still in the trial courts.[4] In still other states, the merits of the refund claims have yet to be reached.[5]

To date, this Court has disposed of four petitions for certiorari in *Davis*-related cases: *Hackman* (denying Missouri's petition), *Harper* (granting and vacating in light of *Beam*), *Bass* (same), and *McManus v. Iowa*, No. 90-1597 (denying retirees' challenge to federal court's 11th Amendment and Tax Injunction Act dismissal of their claims). Pending now are five other petitions: *Pledger v. Bosnick*, No. 91-375 (Arkansas' petition seeking relief from a decision of its highest court predicated on state law); *Nutbrown v. Munn*, No. 91-457 (challenging the requirement of exhaustion of administrative remedies to bring a *Davis* claim under 42 U.S.C.

[2] *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971).

[3] *See Strelecki v. Oklahoma Tax Commission*, No. 77615 (Ok. S.Ct.); *Winstead v. Marx*, No. 91-CC-0475 (Ms. S.Ct); *Brumley v. Utah State Tax Comm'n*, No. 910242 (Utah S.Ct).

[4] *See e.g. Duffy v. Wetzler*, No. 90-07800 (Supreme Court App. Div. 2d Dept.); *Born v. Waddell*, No. 1 CA-TX 90-029 (Ariz. Ct. App.); *Rinehart v. Sizemore*, No. 91-290 (Ala. Ct. of App.); *Ponthier v. Broussard*, No. 344,035 (19th Jud. Dist. Ct. La.).

[5] *See, e.g., Nutbrown v. Munn*, 811 P.2d 131 (Ore. 1991), *pet'n for cert. pend'g*, No. 91-457; *Hogan v. Musolf*, 471 N.W.2d 216 (Wis. 1991), *pet'n for cert. pend'g*, No. 91-380.

§ 1983); *Hogan v. Musolf*, No. 91-380 (same); *Swanson v. Powers*, No. 91-666 (challenging the Fourth Circuit's determination that taxing officials in North Carolina are entitled to qualified immunity under 42 U.S.C. § 1983); *Barker v. Kansas*, No. 91-611 (questioning whether discrimination against military retirees violates 4 U.S.C. § 111). This petition directly poses the question that will eventually be central to all these and the remaining *Davis* cases: does *Beam* require that *Davis* must be applied retroactively? Until unmistakable guidance on this score is provided, this Court will continue to see petitions arising out of the various states affected by the *Davis* decision. Plenary review by this Court is warranted to resolve the divergent state court decisions of the federal question presented here and to forestall needless and repetitive litigation in this and the lower courts.

2. The lower court's reading of *Beam* as allowing for application of a *Chevron* analysis in this case is flawed in two fundamental respects. Following the lead of the *Swanson* court, the court below focused on Michigan's concession in *Davis* that refunds were the appropriate remedy for the invalidation of its tax. *See* 489 U.S. at 817. The court below held that, because the issue of entitlement to refunds was conceded rather than litigated and decided by this Court, the fact that refunds were ordered in *Davis* was not "precedent." *See* App. A at 4a; *Swanson*, 407 S.E.2d at 795. Accordingly, it reasoned, unlike the situation in *Bacchus*,[6] *Davis* did not apply its ruling to the parties before it. The court below thus determined that it was free to engage in a *Chevron* analysis to determine whether *Davis* should be applied retroactively and it affirmed its pre-*Beam* decision in its entirety. App. A at 5a.

The lower court's focus on Michigan's concession that refunds were the appropriate remedy for the invalidation of its tax is misplaced. As *Beam* emphasizes, the substantive question of the constitutionality of a tax and

[6] *Bacchus Imports Ltd. v. Dias*, 468 U.S. 263 (1984).

the remedial question arising upon its invalidation are two distinct questions. 111 S.Ct. at 2443. In *Davis*, the Court held that Michigan's tax violated the Supremacy Clause and 4 U.S.C. § 111. 489 U.S. at 817. Self-evidently, had the Court not invalidated the tax, Michigan's concession would have been of no moment. Similarly, had the Court invalidated Michigan's tax, but not applied its decision to the parties before it, Michigan's concession would have been inconsequential. Michigan's concession only became operative upon the Court's invalidation of the tax *and* its determination to apply that decision to the parties before it.

To be sure, the issue of retroactivity was neither litigated nor even mentioned in *Davis*. But, whether "the prospectivity issue can . . . be said to have been litigated and by implication actually to have been decided by the [*Bacchus*] Court" was "unnecessary" to the holding in *Beam*. *Beam*, 111 S.Ct. at 2445 n.2. *See also id.* at 2448 White, J., concurring) ("even if . . . the Court was quite wrong in [applying its ruling to the parties before it], that is water over the dam, irretrievably"). *Davis* applies retroactively, for the overwhelming presumption is that the Court intends its ruling to apply to the parties before it. *Id.* at 2451 (O'Connor, J., dissenting) ("Given that the usual course in cases before this Court is to apply the rule announced to the parties in the case, the most reasonable reading of [*Bacchus*' silence on retroactivity] is that the Court followed its customary practice.") *See also Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilberson*, 111 S.Ct. 2773, 2787-88 (1991) (O'Connor, J., dissenting) (objecting to retroactive application of the rule announced and noting that the majority opinion did not even mention the issue of retroactivity).

Indisputably, the Court in *Davis* "did not reserve the question of whether its holding should be applied to the parties before it." 111 S.Ct. at 2445. Accordingly, *Davis* must "properly be understood to have followed the normal rule of retroactive application in civil cases." *Id.* Thus,

the court below erred in holding that the concession of refunds in *Davis* allowed it an escape from *Beam*'s command of retroactivity.

The court below's second error is even more insidious. The court misconstrued Justice Souter's comment that "[n]othing we say here deprives respondent of his opportunity to . . . demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided." 111 S.Ct. at 2448. The lower court interpreted this as sanctioning a *Chevron* analysis to deny relief even if *Davis* were retroactive. App. A at 5a. Thus, the court below has read *Beam* to overrule *McKesson*'s mandate of a clear and certain remedy for unconstitutional taxation.

As this Court held in *American Trucking Assn's v. Smith*, 110 S.Ct. at 2332,

> Our decision today in *McKesson* makes clear that once a State's tax statute is held invalid . . . the State is obligated to provide relief consistent with federal due process principles. When the State comes under such a constitutional obligation, *McKesson* establishes that equitable considerations play only the most limited role in delineating the scope of that relief.

Citations omitted. *See also id.* at 2334 ("*McKesson* makes plain that equitable considerations are of limited significance once a constitutional violation is found.") By holding that *Chevron* applies even after a determination of unconstitutionality is made, the court below ignored both *McKesson* and *American Trucking Assn's v. Smith*. If followed, the decision below would hopelessly muddle the civil retroactivity jurisprudence this Court has so arduously striven to establish. Review by this Court is waranted to ensure that this encroachment upon *McKesson* is not allowed.

3. As a general rule, the lower federal court have had little difficulty applying *Beam*. Especially in the context

of determining the retroactive effect of *Lampf*, the federal courts almost uniformly have concluded that *Beam* requires *Lampf* to be applied retroactively. *See, e.g., Bourdeau v. Deloitte, Haskins & Sells*, 942 F.2d 497, 498 (8th Cir. 1991); *Welsh v. Cadre Capital*, —— F.2d —— (1991 WL 197100) (2d Cir. Oct. 7, 1991) (reversing its prior holding that application of new statutes of limitations would be prospective only).[7] In other contexts as well, the lower federal courts have applied *Beam* without apparent difficulty. *See Bethel v. American International Mfg. Corp.*, 768 F.Supp. 327, 329-30 (W.D. Okla. 1991) (reading *Beam* to require retroactive application of a state court decision (*Williams v. Hook*, 804 P.2d 1131, 1138 (Okla. 1990)) that reversed and remanded a dismissal for failure to state a claim).

In contrast, the state courts have had greater difficulty applying *Beam*. For example, in *Stroh Brewery Co. v. Director of the New Mexico Department of Alcoholic Beverage Control*, 816 P.2d 1090 (N.Mex. 1991), the Supreme Court of New Mexico utilized a *Chevron* analysis in refusing to retroactively apply *Healy v. Beer Institute*, 491 U.S. 324 (1989), (*"Healy II"*). The court concluded that *Beam* did not mandate retroactive application, finding "nothing in the *Healy II* opinion to indicate that the holding is to have retroactive effect," 816 P.2d at 1093, and finding an intent to make the decision nonretroactive in the Court's statement that *"Seagram*[8] is no longer good law." *Id.*, 816 P.2d at 1093. In *Healy II*, however, this Court affirmed the Second Circuit opinion, 491 U.S. at 343, which directed entry of judgment in favor of plaintiffs. *In re Beer Institute*, 849 F.2d 753, 761 (2d Cir. 1988). Accordingly, under *Beam*, the *Healy II* plaintiffs did obtain the benefit of the Court's ruling

[7] In *Glick v. Berk & Michaels, P.C.*, 1991 Westlaw 152614 (S.D.N.Y. Jul. 26, 1991), the district court refused to apply *Lampf* retroactively. This holding would not seem viable in light of *Cadre Capital*, however.

[8] *Joseph E. Seagram & Sons v. Hostetter*, 384 U.S. 35 (1966).

and, therefore, the *Stroh Brewery* court should have applied *Healy II* retroactively to the parties before it.[9]

Because of the Eleventh Amendment and the Tax Injunction Act, 28 U.S.C. § 1341, *Davis* claimants are relegated exclusively to state courts to press their claims for refunds. But it is these courts that have demonstrated the greatest difficulty in applying *Beam*. This Court is the only federal court that can hear the retirees' claims; review by this Court is thus necessary to assure a correct and evenhanded application of *Beam* to all federal retirees.

4. This Court in *Beam* did not "speculate as to the bounds or propriety of pure prospectivity." 111 S.Ct. at 2448. If the court below is correct in its holding that *Davis* did not apply its holding to the parties before it and that therefore *Davis*' retroactivity is not determined under *Beam*, then this petition presents the questions left open in *Beam*: is "pure prospectivity" a viable jurisprudential doctrine, and, if so, is *Davis* appropriately applied prospectively only?

Petitioners submit that prospective decisionmaking is not a proper judicial function. Petitioners adopt the position taken by Justice Stevens in his dissent in *American Trucking Assn's v. Smith*, 110 S.Ct. at 2350, *i.e.*, that courts enjoy latitude in fashioning equitable remedies, but that in deciding substantive questions of law, they are bound "to determine the rights of litigants in accordance with [their] best current understanding of the law." Thus, *Chevron* analysis would be relevant only to determining, within constitutionally permissible bounds, an appropriate remedy.

Even if *Chevron* were an appropriate choice of law vehicle, however, *Davis* would nonetheless be entitled to

[9] In at least one other state court case the application of *Beam* has been uncertain. In *Devrnja v. West Virginia Board of Medicine*, 408 S.E.2d 346, 349 (W. Va. 1991), the court expressly shunned reliance on *Chevron, American Trucking Ass'ns* and *Beam*: "We decline to unravel this tangled federal scheme."

retroactive application. The threshold *Chevron* factor is the establishment of a new principle of law. *Chevron*, 404 U.S. at 106; *United States v. Johnson*, 457 U.S. 537, 550 n.12 (1982); *McKesson*, 110 S.Ct. at 2247 n.15. *Davis* does not satisfy this threshold test. In *Davis*, this Court applied the Public Salary Tax Act of 1939 (4 U.S.C. § 111) to the discriminatory taxation at issue, and found the state's disfavored treatment of federal retirees to be unlawful. 489 U.S. at 817. Any new principle of law implicated in *Davis* (if indeed there was one) was announced not by this Court in 1989 but by Congress in 1939. The holding in *Davis* is dispositive on this point:

> We have no difficulty concluding that civil service retirement benefits are deferred compensation for past years of service rendered to the government.
>
> • • • •
>
> [T]he overall meaning of § 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of . . . retirement benefits . . ., except to the extent that such taxation discriminates on account of the source of compensation.
>
> • • • •
>
> Any other interpretation of the nondiscrimination clause [of 4 U.S.C. § 111] would be implausible at best.

Davis, 489 U.S. at 808-10, citations omitted. In light of the ease with which this Court reached its conclusions in *Davis*, and in light of that decision's precedential underpinnings, the contention that *Davis* could satisfy the threshold *Chevron* test is "implausible at best."

Moreover, the equities overwhelmingly favor retroactive application of *Davis*. The sole "equitable" argument for nonretroactive application of *Davis* is that refunds will prove costly to the states. Thus, the court below has held that because Virginia was strapped for cash, the law enacted by Congress in 1939 is inoperative and the taxes collected in violation of that law are not, in fact, unlawful. This is analytically as satisfying as a taxpayer asserting that because he has no money to pay the assessed tax, he owes no taxes. Indeed, it is even more perverse, for it suggests that the greater the magnitude of the constitutional violation, the greater the state's equitable claim not to rectify it.

Nor does this analysis explain why the meager state of the fisc at the time the refund claims are litigated would provide a basis for denying relief altogether. It would seem that if the state is truly unable to pay for its unconstitutional actions, then it should be required to pay what it can and to pay the remainder when it can. But not only is it counterintuitive to excuse the state altogether from liability because of its depleted coffers, it draws the courts well beyond their constitutional powers. It certainly is not a proper judicial function for courts to determine how much of a refund a state can afford to pay and, similarly, at what point a refund becomes so expensive that the underlying conduct must be deemed lawful.

In denying refunds under *Chevron* the court below incorporates this illogic. Petitioners submit that *Chevron* is inapposite to their claims. If *Chevron* is apt, then review by this Court is additionally necessary to address the unprincipled application of that analysis by the court below.

5. In the court below, the Commonwealth sought to distinguish between civil service retirees and retirees of the Armed Forces. The Commonwealth argued that because of the putative differences in the nature of civil service and military retirement, it could deny refunds to military retirees even if it were required to grant refunds to civil service retirees. That is, the Commonwealth argued that it did not violate 4 U.S.C. § 111 by taxing military pensions while exempting state pensions.

This identical issue is presently before the Court in the petition for certiorari in *Barker v. Kansas*, No. 91-611. In *Barker v. Kansas*, 815 P.2d 46 (Kan. 1991), the court

held that Kansas' taxation of military retirees and concomitant exemption of state and federal civil service retirees did not violate 4 U.S.C. § 111 because there were purportedly "significant differences" between the classes. This is the identical argument pressed by the Commonwealth in the courts below.

Without repeating the points made by the petitioners in *Barker*, and the Solicitor General and The Retired Officers Association as *amicus*, petitioners submit that this issue presents an independent ground necessitating plenary review by the Court. Virginia has not and does not distinguish betwen federal civilian retirees and federal military retirees in any of its tax laws. Accordingly, Virginia's attempt to distinguish between these classes of retirees is not anchored in "significant differences" recognized by its legislature. Thus, Virginia's proposed discrimination cannot pass muster under the "significant difference" test reiterated in *Davis*.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari to the Supreme Court of Virginia should be granted.

Respectfully submitted,

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November 15, 1991

APPENDICES

APPENDIX A

SUPREME COURT OF VIRGINIA

Record No. 900770

Present: All the Justices

HENRY HARPER, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

Record No. 900792

LAWRENCE E. LEWY, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

On Remand from the Supreme Court of
the United States

OPINION BY JUSTICE ROSCOE B. STEPHENSON, JR.

November 8, 1991

These cases are before us again, having been remanded for our further consideration from the Supreme Court of the United States.

In *Davis* v. *Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court decided that state taxation of pension income of retired federal government employees, while exempting from taxation pension income of retired state government employees, violated the doctrine of intergovernmental tax immunity embodied in the supremacy clause of the Constitution of the United States. The appellants in the present case (collectively, Harper) filed suits for tax refunds pursuant to Code § 58.1-1826, claiming that the Commonwealth unconstitutionally taxed their federal retirement incomes and that state law requires the refund of those taxes collected during the three-year period preceding the *Davis* decision.

On March 1, 1991, we held that the *Davis* decision is not to be applied retroactively, and accordingly, Harper was not entitled to a refund. *Harper* v. *Virginia Department of Taxation*, 241 Va. 232, 401 S.E.2d 868 (1991). In so doing, we applied the three-pronged test announced in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971). On June 28, 1991, the Supreme Court vacated our March 1, 1991 decision and remanded these cases to us "for further consideration in light of *James B. Beam Distilling Co.* v. *Georgia*, 501 U.S. ——, 111 S.Ct. 2439 (1991)."

The Georgia taxing statute at issue in *Beam* imposed an excise tax on imported alcohol and distilled spirits at a rate double that imposed on alcohol and distilled spirits manufactured from products grown in Georgia. After the decision in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984), in which the Supreme Court held that a Hawaii taxing statute that distinguished between alcoholic products imported from other states and locally manufactured alcoholic products violated the commerce clause of the Federal Constitution, James B. Beam Distilling Company, a Delaware corporation and Kentucky bourbon manufacturer, brought suit in a Georgia trial court, claiming that the Georgia statute likewise was violative of the commerce clause. The distilling company sought a full refund of the taxes paid for the taxable years 1982, 1983, and 1984. Relying upon *Bacchus*, the Supreme Court of Georgia held that the Georgia statute was unconstitutional. The Georgia court, however, refused to apply its ruling retroactively, thereby denying the requested refund. In so doing, the court applied the *Chevron Oil* test. *Beam*, 501 U.S. at ——, 111 S.Ct. at 2442.

The question presented in *Beam* was whether the new rule of law announced in *Bacchus* "should apply retroactively to claims arising on facts antedating that decision." *Id.* at ——, 111 S.Ct. at 2441. The Supreme Court reversed the Georgia court's judgment and remanded the case for further proceedings. *Id.* at ——, 111 S.Ct. at 2448.

The plurality opinion in *Beam* was authored by Justice Souter and joined by Justice Stevens. Justice Souter concluded that *Beam* involved retroactivity as a choice-of-law issue rather than as a remedial issue. *Id.* at ——, 111 S.Ct. at 2443. Justice Souter then set forth three possible solutions to the choice-of-law problem. First, a decision announcing a new rule of law may be made fully retroactive by applying the new rule both to the parties before the court and to all others by and against whom claims are made without regard to when such claims arise. Second, such a decision may be made purely prospective by applying the new rule of law only to cases arising on facts postdating the pronouncement. Third, the new rule could be applied to the parties before the court and the old rule could be applied to all other cases arising on facts predating the decision. *Id.* at ——, 111 S.Ct. at 2443-44. This third possibility, called "modified, or selective, prospectivity," was abandoned in the criminal context in *Griffith* v. *Kentucky*, 479 U.S. 314, 328 (1987). *Beam*, 501 U.S. at ——, 111 S.Ct. at 2444-45. Justice

Souter rejects this concept in the civil context. *Id.* at ——, 111 S.Ct. at 2447.

After concluding that the Supreme Court in *Bacchus* had applied its new rule to the litigants there before the court, Justice Souter stated the following:

> Thus, the question is whether it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so. We hold that it is, principles of equality and *stare decisis* here prevailing over any claim based on a *Chevron Oil* analysis.

Id. at ——, 111 S.Ct. at 2446.

The present case, however, is distinguishable from *Beam*. Although the Supreme Court in *Bacchus* applied its rule retroactively to the litigants in that case, the Court made no such ruling in *Davis*. Indeed, the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated. 489 U.S. at 817.

In order for a case to be precedent for another case, the court in the first case must have decided the issue presented in the second case. *United States* v. *L.A. Tucker Truck Lines*, 344 U.S. 33, 37-38 (1952); *United States* v. *Mitchell*, 271 U.S. 9, 14 (1926); *Webster* v. *Fall*, 266 U.S. 507, 511 (1925). Therefore, because the retroactivity issue was not decided in *Davis*, we are not foreclosed by precedent from applying the three-pronged *Chevron Oil* test in deciding the retroactivity issue in the present case.* *Accord Swanson* v. *North Carolina*, —— N.C. ——, ——, —— S.E.2d ——, —— (1991).

---

* Furthermore, we do not read *Beam* as rejecting the *Chevron Oil* test. Four Justices clearly embrace the test's application in determining retroactivity. Two Justices reject the test, but only in its application to the choice-of-law issue. Only three Justices completely reject the test.

Moreover, as Justice Souter stated in Part IV of the plurality opinion, the grounds for the *Beam* decision are narrow. 501 U.S. at ——, 111 S.Ct. at 2448. "[The grounds] are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." *Id.* at ——, 111 S.Ct. at 2448.

Beam is important not only for what it decided but also for what it did not decide. As Justice Souter wrote:

> We do not speculate as to the bounds or propriety of pure prospectivity.
>
> Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court . . . . Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided . . . .

Id. at ——, 111 S.Ct. at 2448 (citations omitted).

Consequently, having reconsidered our March 1, 1991 decision in light of *Beam*, we conclude that nothing articulated in *Beam* requires a result different from that reached in our prior decision. Accordingly, we reaffirm our prior decision in all respects.

Affirmed.

APPENDIX B

SUPREME COURT OF THE UNITED STATES
Office of the Clerk
Washington, D.C. 20543

June 28, 1991

Mr. Michael J. Kator
1275 K Street, N.W.
Suite 950
Washington, DC 20005-4006

Re: Henry Harper, et al.
v. Virginia Department of Taxation
No. 90-1685
Lawrence E. Lewy, et ux., et al.
v. Virginia Department of Taxation
No. 90-1772

Dear Mr. Kator:

The Court today entered the following order in each of the above entitled cases:

The petition for a writ of certiorari is granted. The judgment is vacated and the case is remanded to the Supreme Court of Virginia for further consideration in light of James B. Beam Distilling Company v. Georgia, 501 U.S. —— (1991).

Very truly yours,

/s/ William K. Suter
WILLIAM K. SUTER
Clerk

APPENDIX C

SUPREME COURT OF VIRGINIA

Record No. 900770

HENRY HARPER, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

Record No. 900792

LAWRENCE E. LEWY, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

From the Circuit Court of the City of Alexandria
DONALD H. KENT, Judge

Present: Carrico, C.J., Compton, Stephenson, Whiting, Lacy, and Hassell, JJ., and Cochran, Retired Justice

OPINION BY JUSTICE ROSCOE B. STEPHENSON, JR.

March 1, 1991

In *Davis* v. *Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court of the United States declared that state taxation of pension income of retired federal government employees, while exempting from taxation pension income of retired state government employees, violated the doctrine of intergovernmental tax immunity embodied in the supremacy clause of the Constitution of the United States. The Supreme Court, however, did not decide whether its decision in *Davis* had retrospective application.[1]

In these consolidated appeals, the appellants (collectively, Harper) are retired federal employees who receive either civil service retirement benefits or military retired pay. They filed suits in the trial court against the Virginia Department of Taxation (the Commonwealth) in May 1989, seeking refunds, pursuant to Code § 58.1-1826, for state income taxes paid for tax years 1985, 1986, 1987, and 1988. After consolidating the several suits, the trial court ruled that *Davis* should be applied prospectively only and, therefore, that Harper was not entitled to the refunds. Harper appeals.

In this appeal, the principal issue is whether *Davis* should be applied only prospectively, thereby denying the refunds, or retroactively, thereby granting the refunds.

I

Whether a constitutional decision of the Supreme Court is applied retroactively is a matter of federal law. *American Trucking Associations, Inc.* v. *Smith*, —— U.S. ——, ——, 110 S.Ct. 2323, 2330 (1990). In the civil context, retroactive application of such decisions is governed by the three-pronged test announced in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971). *Smith*, ——

[1] The Supreme Court did not consider this issue because Michigan conceded that "to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." *Davis*, 489 U.S. at 817.

U.S. at ——, 110 S.Ct. at 2331, *see U.S.* v. *Johnson*, 457 U.S. 537, 563 (1982).

In *Smith*, the Supreme Court considered a state's taxing statute that previously had been declared unconstitutional under the commerce clause of the Federal Constitution. —— U.S. at ——, 110 S.Ct. at 2329. The Court denied the claimant's request for a refund of taxes paid prior to an earlier decision that invalidated the taxing statute. *Id.* at ——, 110 S.Ct. at 2334. In so doing, a plurality of the Court employed the three-pronged *Chevron* test and concluded that its earlier decision should not be applied retroactively. The Court found that its earlier decision invalidating an Arkansas highway tax, *American Trucking Assns., Inc.* v. *Scheiner*, 483 U.S. 266 (1987), established a "new principle of law" under the commerce clause. *Id.* at ——, 110 S.Ct. at 2332. Arkansas's legislature, therefore, was justified in relying upon existing precedent and had "good reason to suppose" the enactment of the tax would not violate the Federal Constitution. *Id.* at ——, 110 S.Ct. at 2333.

Harper contends, nonetheless, that "because the taxes at issue here . . . constitute[d] an 'unconstitutional deprivation,' . . . Virginia must provide "backward-looking relief' to the refund claimants." Harper asserts that such relief is required by the holding in *McKesson Corp.* v. *Division of Alcoholic Beverages and Tobacco*, —— U.S. ——, 110 S.Ct. 2238 (1990).

In *McKesson*, decided on the same day as *Smith*, the Supreme Court held that a "clear and certain remedy," which could include refunds, was required to remedy Florida's unconstitutional liquor tax statute. —— U.S. at ——, 110 S.Ct. at 2252. In so holding, the Court rejected Florida's contention that its taxing authority implemented the tax preference scheme "'in good faith reliance on a presumptively valid statute.'" *Id.* at ——, 110 S.Ct. at 2254. In rejecting that contention, the Court

stated that the challenged tax statute "reflected only cosmetic changes from the prior version of the tax scheme that itself was virtually identical to the Hawaii scheme invalidated" in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984). Thus, the Court concluded, Florida "[could] hardly claim surprise" when its later statute was invalidated. *Id.* at ——, 110 S.Ct. at 2255.

In the present case, nothing in the record suggests that the Commonwealth acted other than in good faith reliance upon a presumptively valid taxing statute. We conclude, pursuant to *Smith*, that the three-pronged *Chevron* test must be employed to determine whether the *Davis* decision should be applied prospectively only.

A

For a decision to be applied prospectively only, the first prong of the *Chevron* test requires that the decision "establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." 404 U.S. at 106. Satisfaction of this first prong usually has been stated as the "threshold test" for determining whether or not a decision should be applied prospectively only. *Johnson*, 457 U.S. at 550 n.12.

When *Davis* was decided, 23 states had statutes similar to the Michigan statute.[2] Virginia's statute had been in

[2] *See* Ala. Code Sections 36-27-28 and 40-18-19 (Supp. 1988); Ariz. Rev. Stat. Ann. Section 43-1022 (Supp. 1988); Ark. Code Ann. Section 25-51-3206; Colo. Rev. Stat. Section 39-22-104(4)(f) and (g) (Supp. 1988); Ga. Code Ann. Section 48-7-27(a)(4)(A) (Supp. 1988); Iowa Code Ann. Section 97A.12 (West 1984); Kan. Stat. Ann. Section 74-4923(b) (1985); Ky. Rev. Stat. Ann. Section 16.690 (Michie/Bobbs-Merrill Supp. 1988); La. Rev. Stat. Ann. 47:44.1 (Supp. 1989); Mich. Comp. Laws Ann. Section 206.30 (1988); Miss. Code Ann. Section 25-11-129 (1972); Mo. Rev. Stat. Section 86.190 and 104.540 (1986); Mont. Code Ann. Section 15-30-111(2) (1987); N.M. Stat. Ann. Section 10-11-145 (1978); N.Y. Tax Law Section 612(c)(3) McKinney (1987); N.C. Gen. Stat. Section 135-9 (1988); Okla. Stat. tit. 68 § 2358 (1988); Ore. Rev. Stat. Section 316.680(1)(c) and (d) (1987); S.C. Code Section 12-7-435(a), (d), and (e) (Supp. 1988); Utah Code Ann. Section 49-1-608 (1989); Va. Code Section 58.1-322(C)(3) (Supp. 1988); W.Va. Code Section 11-21-12(c)(5) and (6) (Supp. 1988); Wis. Stat. Section 71.05(1)(a) (Supp. 1988).

effect for almost half a century. *See* Acts 1942, c. 325. As far as the record shows, the federal pensioners had paid the tax without protest. Not a single federal pensioner had brought an action during that period in a Virginia court seeking a refund of taxes on the basis of the intergovernment tax immunity doctrine. The absence of such litigation reasonably may be explained by examining the doctrine's origin and development.

The intergovernmental tax immunity doctrine had its genesis in *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 316 (1819). The doctrine was grounded on the proposition that "[s]tates have no power, by taxation or otherwise, to retard, impede, burden or in any other manner control, the operations [of the federal government]." *Id.* at 436.

The pre-*Davis* cases invalidating state taxing statutes were decided on the proposition that the tax had a foreseeable and direct effect on some operation of the federal government. *See, e.g., Memphis Bank & Trust Co.* v. *Garner*, 459 U.S. 392 (1983) (state tax that imposes greater burden on holders of federal obligations than on holders of similar state obligations impermissibly discriminates against securities issued by federal government); *Phillips Chemical Co.* v. *Dumas Indep. Sch. Dist.*, 361 U.S. 376 (1960) (state tax that imposes greater burden on lessees of federal property than on lessees of other exempt public property impermissibly discriminates against federal government). Indeed, *Davis* states that intergovernmental tax immunity is based on "the need to

protect each sovereign's governmental operations from undue interference by the other." 489 U.S. at 814.

In the present case, it is difficult to discern how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation. Consequently, we conclude that the *Davis* decision established a new rule of law by deciding an issue of first impression whose resolution was not clearly foreshadowed. Thus, the first prong of the *Chevron* test is satisfied.

B

The second *Chevron* prong requires a court to "weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." 404 U.S. at 106-07. In applying this factor, we must determine whether the intergovernmental tax immunity doctrine will be retarded or furthered by retroactive application of the *Davis* decision.

The purpose of intergovernmental tax immunity is not to prevent legitimate state taxation. *See Smith*, —— U.S. at ——, 110 S.Ct. at 2332. Virginia's taxing statute was legitimate until a new rule was announced in *Davis*. As soon as the General Assembly became aware of the *Davis* decision, it acted to correct the defects in its statute. *See* Acts 1989, Special Session II, c. 3. As a result, the purpose of the intergovernmental tax immunity doctrine already has been fully served, and applying *Davis* retroactively would do nothing either to retard or to further the doctrine's purpose. Therefore, the second prong of the *Chevron* test is satisfied.

C

The third prong of the *Chevron* test requires a court to "[weigh] the inequity imposed by retroactive application." 404 U.S. at 107. In weighing the equities, con-

siderable deference must be accorded a state's reliance upon a statute that was presumptively valid. *See Lemon* v. *Kurtzman*, 411 U.S. 192 (1973). Indeed, "[i]t is well established that reliance interests weigh heavily in the shaping of an appropriate equitable remedy." *Id.* at 203. As Chief Justice Burger so aptly stated in *Lemon*, "statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity." *Id.* at 199.

An important equitable consideration is the effect that retroactive application of a judicial decision may have on a state's financial stability. As the *Smith* plurality acknowledged, applying a judicial decision retroactively may "have potentially disruptive consequences for the State and its citizens. A refund, if required by state or federal law, could deplete the state treasury, thus threatening the State's current operations and future plans." —— U.S. at ——, 110 S.Ct. at 2333.

In *Arizona Governing Committee* v. *Norris*, 463 U.S. 1073, 1105 (1983), the Supreme Court held that the State of Arizona's voluntary pension plan violated Title VII of the Civil Rights Act of 1964. The Court further held, however, that the state's liability would be prospective only. *Id.* The Court found that retroactive liability could cost the state hundreds of millions of dollars. As Justice Powell stated, "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Id.* at 1106-07. Because the illegality of Arizona's actions had not been declared until *Norris* was decided, Justice Powell further stated that "[t]here is no justification for this Court . . . to impose this magnitude of burden retroactively on the public." *Id.* at 1107.

In the present case, the record discloses that retroactive application of the *Davis* decision would give rise

to a potential tax refund liability, inclusive of interest, of approximately $440,000,000. This liability would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits. The record contains affidavits of Commonwealth officials that support the conclusion that allowing the requested refunds would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services.

Harper contends, nonetheless, that "it is simply more equitable to place the financial consequences . . . upon the government (and thus the whole body of taxpayers) than upon a small subclass of taxpayers who had unconstitutionally been forced to pay the tax in the first instance." Thus, Harper asserts, "taxpayers who have been paying more than their lawful share of taxes should be reimbursed by those who have paid less."

The Commonwealth counters by pointing out that "hundreds of thousands of other Virginia taxpayers have paid taxes on their private pension income but have no claim for monetary relief." The Commonwealth further asserts that "over 2.5 million Virginians annually have paid their 'fair share' of taxes while only some sixty thousand state and local retirees were excluded from pension income taxation."

The record supports the Commonwealth's assertions, and we conclude that, on balance, the equities weigh heavily in favor of the Commonwealth. Consequently, the third prong of the *Chevron* test is satisfied.

Accordingly, we hold that, under the *Chevron* test, the *Davis* decision is not to be applied retroactively. *Accord Bass* v. *State*, 395 S.E.2d 171 (S.C. 1990).

II

Harper contends, nonetheless, that the refunds are due as a matter of state law. He relies upon Code §§ 58.1-1825 and -1826. Code § 58.1-1825 provides that "[a]ny

person assessed with any tax administered by the Department of Taxation and aggrieved by any such assessment may . . . within three years from the date such assessment is made, apply to a circuit court for relief." Code § 58.1-1826 provides, in pertinent part, as follows:

> If the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order that the assessment be corrected. If the assessment exceeds the proper amount, the court may order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the court shall order that the applicant pay the proper taxes and to this end the court shall be clothed with all the powers and duties of the authority which made the assessment complained of as of the time when such assessment was made and all the powers and duties conferred by law upon such authority between the time such assessment was made and the time such application is heard. The court may order that any amount which has been improperly collected be refunded to such applicant.

Harper asserts that, even if the *Davis* decision applies prospectively only, the federal retirees are entitled to refunds under Code § 58.1-1826. Harper argues that, because the assessments are unconstitutional, they also are "erroneous or improper."

We reject this argument. We hold that, because the *Davis* decision is not to be applied retroactively, the pre-*Davis* assessments were neither erroneous nor improper within the meaning of Code § 58.1-1826.

Harper's state-law contention also fails for another reason. We previously have held that this Court's ruling declaring a taxing scheme unconstitutional is to be applied prospectively only. *Perkins* v. *Albemarle County*, 214 Va.

240, 198 S.E.2d 626, *aff'd and modified on rehearing*, 214 Va. 416, 200 S.E.2d 566 (1973).[3] We adhere to our holding in *Perkins*. In so dong, we follow the criteria stated in *Fountain* v. *Fountain*, 214 Va. 347, 348, 200 S.E.2d 513, 514 (1973), *cert. denied*, 416 U.S. 939 (1974), that "consideration should be given to the purpose of the new rule, the extent of the reliance on the old rule, and the effect on the administration of justice of a retroactive application of the new rule." *See also Quick* v. *Harris*, 214 Va. 632, 634, 202 S.E.2d 869, 871 (1974), *cert. denied*, 420 U.S. 907 (1975).

III

Finally, Harper contends that "even if *Davis* were applied prospectively only, refunds for 1988 taxes would nonetheless be due, for they were not assessed, and in many cases were not paid, until *after Davis* was decided." (Emphasis in original.) *Davis* was decided on March 28, 1989. The last day for filing individual income tax returns for the 1988 taxable year was May 1, 1989. Harper claims that the last day for filing income tax returns is the date on which income taxes are assessed for the preceding year.[4] We do not agree.

[3] The case of *Capehart* v. *City of Chesapeake*, No. 5459 (Circuit Court, City of Chesapeake, decided Oct. 16, 1974), followed *Perkins*. In *Capehart*, more than one hundred taxpayers in the City of Chesapeake, who had been subjected to the same practice that was invalidated in *Perkins*, brought suit in circuit court seeking, among other things, refunds of the taxes "illegally and unconstitutionally assessed." The City demurred, citing *Perkins*. The circuit court sustained the demurrer, being of opinion that the case was controlled by *Perkins*. We denied Capehart's petition for appeal, 215 Va. xlvii, and Capehart's petition for certiorari raising due process grounds was denied by the Supreme Court, 423 U.S. 875 (1975).

[4] Harper's reliance upon Code § 58.1-1829 is misplaced. Section 58.1-1829 defines "assessment" as that term is used in Article 2 of Chapter 18, which establishes limitation periods for various forms of relief. Individual income tax liability is established in Article 2 of Chapter 3.

Income taxes are "imposed on the Virginia taxable income *for each taxable year* of every individual." Code § 58.1-320. (Emphasis added.) The taxable year ended on December 31, 1988, almost three months before *Davis* was decided. When the year ended, the 1988 tax was fixed and ascertainable. Only payment of the tax was delayed until May 1, 1989. Code § 58.1-341.

The Supreme Court rejected a similar contention in *Smith*. The Court reasoned that tax liability depends upon the "'occurrence of the taxed transaction or the enjoyment of the taxed benefit, not the remittance of the tax.'" *Smith*, —— U.S. at ——, 110 S.Ct. at 2335. As Justice O'Connor observed,

> [a] contrary rule would give States a perverse incentive to collect taxes far in advance of the occurrence of the taxable transaction. It would also penalize States that do not immediately collect taxes, but nevertheless plan their operations on the assumption that they will ultimately collect taxes that have accrued.

Id. at 2336.[5]

In sum, we hold that, (1) under the *Chevron* test, the *Davis* decision is not to be applied retroactively, (2) state law does not require tax refunds, but to the contrary, grants prospective-only application to decisions that invalidate a taxing scheme, and (3) our denial of refunds includes taxes due for the tax year 1988. Accordingly, the trial court's judgment will be affirmed.

Record No. 900770—*Affirmed*,

Record No. 900792—*Affirmed*.

[5] For the same reason, we reject the contention in *Lowe* (Record No. 900792) that the trial court erred in denying injunctive relief that would have barred the Commonwealth from filing any action to collect taxes from those who, after the *Davis* decision, had refused to pay the 1988 taxes.

APPENDIX D

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

Law No. CL891080

HENRY HARPER, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL890462

JOHN and FRANCIS MORRIS,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL890463

GEORGE and HELEN RABIL,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL891079

LAWRENCE and MIRIAM LEWY, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

Law No. CL891081

RAYMOND S. WEBSTER, *et al.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant.

ORDER

These five tax refund actions filed under Va. Code § 58.1-1825 and § 58.1-1826 against the Virginia Department of Taxation were heard and decided together upon the suggestion of the parties. The matter is presently before the Court on Cross-Motions for Summary Judgment filed by the defendant and the individual federal retiree plaintiffs in each case, the parties having agreed there are no material facts which are genuinely in dispute. Upon consideration of the pleadings and memoranda submitted by the parties, the affidavits filed by the plaintiffs and defendant and made part of the record by agreement of the parties, and the oral arguments heard by the Court on February 2, 1990, the Court, in accordance with its letter opinion dated February 12, 1990, rules as follows:

In each of these cases, the Court finds that the taxes challenged by plaintiffs were imposed under a valid stat-

ute which was not called into question until the United States Supreme Court decided *Davis v. Michigan Department of Treasury*, 109 S.Ct. 1500 (1989). The question before this Court is whether this is an appropriate case for prospective application of an unprecedented judicial decision. The determination of the retroactivity of judicial decisions is governed by the factors set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971):

- *Davis* decided an issue of first impression whose resolution was not clearly foreshadowed;
- prospective application of *Davis* will not retard its operation; and
- retroactive application would result in inequity, injustice and hardship.

It is clear to the Court that all of these factors are met in the present case, and that the *Davis* decision does not apply retroactively. This being so, the Court holds that:

- the taxes complained of were not erroneous or improper;
- plaintiffs therefore are not entitled to the requested refunds for taxable years 1985 through 1988.

Accordingly, it is hereby ORDERED that defendant's Motion for Summary Judgment is GRANTED, and plaintiffs' Motions for Partial Summary Judgment are DENIED. The provisions of Rule 1:13 shall be dispensed with except as to Michael J. Kator, Esquire, admitted *pro hac vice* in these proceedings as counsel for all plaintiffs, and local counsel George J. Rabil, Esquire. The Clerk of this Court is directed to reflect in the record in each of these cases that judgment is entered in favor of the defendant; and to mail an attested copy of this Order to all counsel of record.

Entered this 12th day of March, 1990.

/s/ Donald H. Kent
DONALD H. KENT
Judge

Seen and agreed to:

/s/ Gail Starling Marshall
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APPENDIX E

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Jasper D. Alspaugh
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Edward B. Ballard
A. Jackson Barden
Raymond R. Barkalow
Philip Barsch
Raymond E. and
C. Louise Bauer
Rex W. Beasley, Jr.
Charles R. Beatty
Richard L. Bell
Alva O. Benson
George L. Beyer
R.J. Bishop
Harold G. Blodgett
Elwyn E. Bobbitt
Donald Boegehold
Fred Bone
Helen A. Boone
Herman Boschen, Jr.
Mack W. Bradley
John G. Brady
George Brinkmann
George K. Brite
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Glover N. Buck
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Y. Kirk Burch
Warren R. Burton, Sr.
Hal H. Bush
Mary C. Calhoun
Joseph Caretta, Jr.
Roy N. Carter, Sr.
Augustus Cartos
Josephine A. Clark
Mr. and Mrs.
Russell R.S. Clem
Paul Comisarow
Patrick J. Connolly
Joseph Connors
Mrs. Marian Canady Cooper
Raymond and Evelyn Copple
Charles F. Corns
Ida M. Costello
Christy W.M. Cottrill
William H. Craig
Davis H. Crawford
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Mrs. Luch Cuthbertson
Anthony J. Daniels
Edwin E. Davenport
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Anna B. Elcan
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Clyde W. Elliott
James Elmore
George W. Ema
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Donald R. Engle
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Dorothy H. Eubank
Jean M. Evans
Isabel W. Fambrough
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Mary B. Hickman
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Samuel C. Hill
Gladys H. Hirdler
Bertie E. Hislop
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William E. Holt
Oscar J. Honeycutt
James W. Horsley
Harvey M. Horton
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Arnold S. Hudgins

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Mrs. Rae S. Hughes
Harry L. Hughes
Mark V. Hughes, Jr.
Norman Jack
Charles F. Janes
Paul J. Jehlik
Kenneth W. Jenkins
Clarence M. Johnson
Lewis R. Johnson
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Calvin C. Jones
Marshall Jones
Edward A. Jones
Joan Jones
James F. Kaar
Wilson K. Kaiser
Jackson E. Kelly
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Joseph Mirabella
Miss Ruth E. Mitchell
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J. Herman Moore
Georgette C. Moore
Joanna H. Morris
William G. Mount
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Phyllis Muhleman
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Rose S. Musumeci
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Ernest C. Quillen
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John M. Roberson
Wayne G. Roberts
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Mack Ward
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Mary O. Weissenborn
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(2)

No. 91-794

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In The

Supreme Court of the United States

October Term, 1991

HENRY HARPER, *et al.*,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

Petition For A Writ Of Certiorari To The Supreme Court Of Virginia

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

The Supreme Court of Virginia decided a federal question when it determined that *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), should not be applied retroactively. As an alternative holding, the Virginia Supreme Court decided as a matter of state law that the state tax refund remedy sought by these Petitioners was unavailable. Petitioners do not argue that this alternative state law holding was in any way inconsistent with, or should have been overridden by, principles of federal law. The question for decision at this stage of the case, therefore, is whether the state law basis for the judgment below presents an adequate and independent state law ground that, under accepted principles, precludes the exercise of jurisdiction by this Court to review the federal question presented by the Petition for Certiorari.

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No. 91-794

In The

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VIRGINIA DEPARTMENT OF TAXATION,

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Petition For A Writ Of Certiorari To The Supreme Court Of Virginia

BRIEF IN OPPOSITION TO PETITION FOR A WRIT OF CERTIORARI

STATEMENT OF THE CASE

The question in this case is whether the Commonwealth of Virginia is obligated under state or federal law to repay to the Petitioners and other similarly situated claimants tax refunds in excess of $440 million. The federal component of the Petitioners' claim is based on *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989) (*"Davis"*).

Petitioners are retired federal employees who receive federal pension benefits and former members of active military service who receive military pay. More than 192,000 federal and military retirees live in Virginia – no other state has as many.

In May of 1989, these Petitioners filed suits in state court against the Virginia Department of Taxation (hereafter "Commonwealth"), seeking refunds for state income taxes paid for the taxable years 1985, 1986, 1987 and 1988. The suits were filed under Va. Code Ann. § 58.1-1826 (1991), which provides that "[i]f the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order [refunds]." The Petitioners' claim was that *Davis* applied retroactively to the state taxes collected in the years in question, and that the taxes were "erroneously and improperly assessed" under this provision of state law. Analytically, therefore, the case presented a situation where a state remedy was being sought to enforce a federal right.

The state trial court on cross motions for summary judgment on the issue of liability denied Petitioners relief and the Supreme Court of Virginia affirmed.[1] In an opinion published at 241 Va. 232, 401 S.E.2d 868 (1991), the Virginia Supreme Court held two things, as we elaborate below: (1) that no federal right had been established; and (2) that in any event the state remedy was not available on the facts presented.

The Petitioners sought certiorari in this Court from the Virginia Supreme Court's original decision on the ground, among others, that the Virginia Supreme Court was in error in applying the principles of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) (*"Chevron"*), to determine whether *Davis* should be given retroactive application. At the time that petition was filed, argument had been heard

[1] Because summary judgment was granted to the Commonwealth, no evidence has been taken on the proper calculation of any refunds.

and decision was pending in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991) (*"Beam"*), which presented an analogous issue. This Court followed its normal practice of withholding action on the Petition for Certiorari in this case until *Beam* was decided. Again it followed its normal practice after the decision in *Beam*, by granting certiorari, vacating the Virginia Supreme Court decision, and remanding for further consideration in light of *Beam*.

The Supreme Court of Virginia has now reconsidered its former decision, found that the holding in *Beam* did not require a different result, and reaffirmed its former decision "in all respects." Petition for Certiorari, App. A. at 5a. It therefore reconsidered and reaffirmed its position that: (1) no federal right had been established; and (2) in any event the state remedy sought by the Petitioners was not available on the facts presented. The Petitioners seek certiorari from that reconsideration.

The state tax challenged in this case was originally adopted in 1942. *See* Ch. 325, 1942 Va. Acts 481, 500 (Reg. Sess.). It was not challenged or protested by any taxpayer for nearly 50 years. After this Court's March 28, 1989, decision in *Davis*, these Petitioners "discovered" that it had been clear for all of these 50 years that the tax was unconstitutional and should never have been assessed or collected.

Whatever the merits of that position, it is at least clear that such taxes could not be imposed *after* March 28, 1989. None have been. The Virginia General Assembly met in special session shortly after *Davis* was decided, repealed the tax under litigation in this case, and substituted a system of taxation for pensioners' income that is indisputably acceptable under *Davis* standards. Neither

these Petitioners nor any other taxpayers have suggested that the new tax suffers from any constitutional infirmity.

It is important at the outset to set forth the analytical structure of the issues presented in the Petition for Certiorari. Three quite separate steps are required before the Petitioners can prevail on the merits.

First, they must establish that assessment and collection of the pre-*Davis* taxes violated a federal right. This question turns on several issues of federal law, but fundamentally involves whether *Davis* is to be applied retroactively to the taxes at issue here, all of which were based on taxable events that occurred prior to the *Davis* decision.

Second, if they can establish that a federal right was violated, they must then establish that the particular state remedy on which they have based their suit supports the relief they seek. The cause of action asserted by the Petitioners here is based on state, not federal, law. It is based on one particular state claim, not others that might have been asserted. The questions of state law posed by their reliance on the particular state claim they have asserted are for the Supreme Court of Virginia to resolve. Those questions have been resolved by the Virginia Supreme Court against the Petitioners in this case.

Third, since the questions of state law have been resolved against them by the Virginia Supreme Court, the Petitioners can prevail in this Court only by advancing reasons founded on federal law that would displace the state-law conclusions on which the judgment below rests. As we will elaborate, they have not sought to do so. Nor could they do so. It follows that the Petition for Certiorari should be denied. Under the rationale of the opinion below, and given the federal questions the Petitioners

have raised in this Court, any resolution by this Court of the issues of federal law raised by the Petitioners will have no impact on the outcome of this lawsuit. When a case is in this posture, it is traditional for this Court not to reach out to resolve federal issues that may be of importance to some other case, but cannot be for this one.

REASONS FOR DENYING THE WRIT

1. The Retroactivity Question.

The federal issues presented by this case turn at the outset on application of this Court's decision in *Beam*. *Beam* held that decisions of this Court cannot be selectively prospective, that is, cannot be applied to the parties before the Court but not to others whose claims are based on facts that arose before the decision. That is all that *Beam* held. *Beam* was by its own terms a "narrow" decision:

> The grounds for our decision today are narrow. They are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata. We do not speculate as to the bounds or propriety of pure prospectivity.

111 S. Ct. at 2448.

Disposition of the federal questions that arise in this case, and specifically whether this Court's decision in *Davis* can be the source of the federal rights asserted, necessarily involves the resolution of a number of issues left open in *Beam*. The first is whether *Davis* is, as a choice-of-law matter, a candidate for "pure" prospectivity. The Virginia Supreme Court held, in effect, that it

was. In its first decision in this case, the Virginia Supreme Court applied the *Chevron* factors and concluded that *Davis* should not be applied to tax years that had ended before the *Davis* decision. Petition for Certiorari, App. C at 14a. After this Court's remand order, the Virginia Supreme Court again considered this issue. It held that *Davis* itself did not resolve the question whether the ruling in that case applied to the parties before the Court and that it followed (applying the reasoning of *Beam*) that the issue of prospective or retroactive application of *Davis* was still open. Given this premise, the Virginia Supreme Court decided that its former resolution was still a correct and viable option, and adhered to this aspect of its former judgment.

It may be that this basic question – whether a *Chevron* analysis may be applied to resolve the choice-of-law issue presented by *Davis* – presents an issue of sufficient generality and importance to warrant the grant of certiorari in an appropriate case. But this is not that case, for reasons fully recognized in the Petition for Certiorari itself.

2. Equitable Considerations.

Petitioners embrace "the position taken by Justice Stevens in his dissent in *American Trucking Associations v. Smith*, 110 S. Ct. at 2350, *i.e.*, that courts enjoy latitude in fashioning equitable remedies. . . . " Petition for Certiorari at 9. They agree that "*Chevron* analysis would be relevant . . . to determining, within constitutionally permissible bounds, an appropriate remedy." *Id.* It is this point, and this concession, that ultimately makes this case an inappropriate vehicle for resolution of the retroactivity-of-*Davis* issue that Petitioners seek to raise.

There are a number of equitable considerations that are an appropriate part of the remedial issues raised by this case. The ultimate question to be faced is who should bear the cost of not having foreseen the invalidating decision in *Davis*. There can, of course, be no debate that *Davis* was not in fact foreseen. We know that it was not foreseen by these Petitioners, because they and many like them paid the taxes in question without protest for almost 50 years. Hundreds of thousands of taxpayers had paid this tax in Virginia from its enactment in 1942 until the *Davis* litigation (as had taxpayers over approximately the same period of time in 22 other states), without any suggestion that there might be a constitutional problem or any other legal difficulty with its imposition. As to the Virginia taxing officials, the Virginia Supreme Court correctly observed in its first opinion below that there is nothing in the facts or background of this case to suggest "that the Commonwealth acted other than in good faith reliance upon a presumptively valid taxing statute." Petition for Certiorari, App. C at 10a. One can search the litigated cases, the applicable administrative proceedings, and the relevant literature in vain for any warning or prediction that either the tax-paying or the tax-imposing communities anticipated the *Davis* result before it was announced. The simple fact is that no one – neither the Petitioners nor the Commonwealth nor their counterparts in 22 other states – recognized the constitutional infirmity in this particular Virginia tax prior to its articulation in the *Davis* decision. If a constitutional harm was occurring during this period of time, no one knew it or perceived injury from it.

As the Commonwealth argued below and as the Virginia Supreme Court held, there can be no doubt about

where the equities lie in this case. The Petitioners seek a windfall, the repayment of taxes which they thought to be lawful when paid and which have long since been budgeted and spent for state services, the benefits of which these Petitioners – like the other citizens of the Commonwealth – have fully enjoyed. They seek to shift the cost of those services, after the fact, to other taxpayers, taxpayers who are entirely innocent in this controversy and who – unlike them – have not slept on their rights for 50 years. A judgment in favor of the Petitioners will be paid by other taxpayers either through an increase in taxes or a reduction in services. In either event, there will be proportionally less money for the state's public school system, for law enforcement and corrections, for social programs, and for a wide variety of other state services. At the margins, those who will suffer the most will be those who are least able to provide fully for their own needs. What the Petitioners seek is the redistribution of $440 million from the other citizens of the Commonwealth to themselves and other similarly situated taxpayers as compensation for an abstract injury of which they were not even aware when it occurred.

And the "constitutional harm" which they have suffered is indeed abstract. One appropriate factor to aid the resolution of where the equities lie in a case of unforeseen constitutional developments is the nature of the harm suffered by the individual. These taxpayer-Petitioners were not harmed as the result of the denial of a personal constitutional right found in the Bill of Rights or the Fourteenth Amendment. No one broke into their homes; no one denied their freedom to speak or to worship; no one denied their right to a fair adjudication of criminal

charges. They were "harmed" because the Commonwealth of Virginia and 22 other states innocently failed to anticipate the correct interpretation of a principle of intergovernmental tax immunity that is designed to order the relationship between federal and state government, not – as in the case of the other rights mentioned above – the relationship between government and the individual citizen. We do not mean to suggest, of course, that these Petitioners do not have "standing" in the constitutional sense to complain about the violation of a prophylactic principle designed to order the relationship between two sovereigns, but we do suggest that their role in advancing their own interests in the name of protecting that relationship can adequately be served without conferring upon them a windfall profit at the expense of the remainder of the Commonwealth's tax-paying community. Put another way, prospective relief – freedom from future imposition of the taxes, already accomplished here by repeal of the offending tax – ought to be regarded as both an adequate incentive to bring such suits in the future (and thus insure protection of the principle of intergovernmental immunity) and an adequate remedy for uncovering the violation of the constitutional right. It is the interests of the United States that are really at stake here, and those interests are not advanced – indeed, they are undermined – by inhibiting the ability of the States to meet the basic needs of their citizens by such massive transfers of money (potentially billions of dollars nationwide) from the hands of the many to the hands of a few.

It is also important to examine the "constitutional harm" suffered by these Petitioners from another perspective. It is not our tradition that "constitutional harms" are always remedied by compensatory relief. Two

examples come readily to mind. In the school litigation inaugurated by *Brown v. Board of Education*, 347 U.S. 483 (1954), there was never any suggestion of retrospective compensatory relief to all of the school children who suffered the constitutional injuries remedied by that decision. The same was true, albeit in a dramatically different context, in *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), the result of which was that the declaration that the Bankruptcy Act of 1978 was unconstitutional was given only prospective effect.

A third example is provided by this very case. No one is suggesting, in this litigation or in any of the litigation based on the *Davis* decision, that relief should be fully retroactive past the point where, for example, a state statute of limitations would preclude a refund remedy. There thus will not be "full" retroactive compensatory relief under any view of the present litigation. There is an important insight underlying this observation: the fact that it is recognized that *some* doctrinal formulations of state law (a statute of limitations, for example) can serve to cut off an asserted right to compensatory relief for the past "constitutional harm" involved in this case suggests that other doctrinal formulations in which the state seeks to close the book on prior transactions for similar and equally valid reasons should be given the same effect.

This is precisely what has happened in this case – that is, the Virginia Supreme Court has adopted a doctrinal formulation of state law that effectively recognizes repose interests similar to those typically formulated in a statute of limitations, and that forecloses relief to the Petitioners in this case *even if* imposition and collection of the tax in question violated the Constitution for the years

involved in this suit. It is to the development of this point that we now turn.

3. The Adequate and Independent State Ground.

The Virginia Supreme Court reached this result in Part II of its original opinion, affirmed on remand. Part I applied the *Chevron* factors and held that *Davis* was not to be applied retroactively. The Petitioners had argued that they were nonetheless entitled to relief under state law irrespective of the outcome of their federal claim. The Virginia Supreme Court first rejected that argument, holding that "because the *Davis* decision is not to be applied retroactively, the pre-*Davis* assessments were neither erroneous nor improper within the meaning of Code § 58.1-1826."[2] Petition for Certiorari, App. C at 15a. Beyond that, the Court continued:

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[2] Section 58.1-1826 provides in full as follows:

If the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order that the assessment be corrected. If the assessment exceeds the proper amount, the court may order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the court shall order that the applicant pay the proper taxes and to this end the court shall be clothed with all the powers and duties of the authority which made the assessment complained of as of the time when such assessment was made and all the powers and duties conferred by law upon such authority between the time such assessment was made and the time such application is heard. The court may order that any amount which has been improperly collected be refunded to such applicant. A

(Continued on following page)

> Harper's state-law contention also fails for another reason. We previously have held that this Court's ruling declaring a taxing scheme unconstitutional is to be applied prospectively only. *Perkins v. Albemarle County*, 214 Va. 240, 198 S.E.2d 626, *aff'd and modified on rehearing*, 214 Va. 416, 200 S.E.2d 566 (1973). We adhere to our holding in *Perkins*. In so doing, we follow the criteria stated in *Fountain v. Fountain*, 214 Va. 347, 348, 200 S.E.2d 513, 514 (1973), *cert. denied*, 416 U.S. 939 (1974), that "consideration should be given to the purpose of the new rule, the extent of the reliance on the old rule, and the effect on the administration of justice of a retroactive application of the new rule." *See also Quick v. Harris*, 241 Va. 632, 202 S.E.2d 869, 871 (1974), *cert. denied*, 420 U.S. 907 (1975).

Petition for Certiorari, App. C at 15a-16a. In a footnote omitted from the above passage, the Court added:

> The case of *Capehart v. City of Chesapeake*, No. 5459 (Circuit Court, City of Chesapeake, decided October 16, 1974), followed *Perkins*. In *Capehart*, more than one hundred taxpayers in the City of Chesapeake, who had been subjected to the same practice that was invalidated in *Perkins*, brought suit in circuit court seeking, among other things, refunds of the taxes "illegally and unconstitutionally assessed." The City demurred, citing *Perkins*. The circuit court sustained the demurrer, being of opinion that the case was controlled by *Perkins*. We denied

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(Continued from previous page)

copy of any order made under this section or § 58.1-1827 correcting an erroneous or improper assessment shall be certified by the clerk of the court to the Tax Commissioner.

> Capehart's petition for appeal,[3] 215 Va. xlvii, and Capehart's petition for certiorari raising due process grounds was denied by the Supreme Court. 423 U.S. 875 (1975).

Petition for Certiorari, App. C at 16a n. 3. Finally, in its summation of its holding in Part IV of its original opinion in this case, the Virginia Supreme Court said:

> In sum, we hold that, (1) under the *Chevron* test, the *Davis* decision is not to be applied retroactively, [and] (2) state law does not require tax refunds, but to the contrary, grants prospective-only application to decisions that invalidate a taxing scheme. . . .

Petition for Certiorari, App. C at 17a.[4]

Several things need to be said about these passages. First, it is clear that the Virginia Supreme Court is relying solely on state law in the conclusions stated. This is not a case where "a state court decision fairly appears to rest primarily on federal law, or to be interwoven with the federal law, and when the adequacy and independence of any possible state law ground is not clear from the face of the opinion." *Michigan v. Long*, 463 U.S. 1032, 1040-41 (1983). There is thus no need for the "plain statement" of exclusive reliance on state law grounds contemplated by

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[3] This denial of the petition for appeal by the Virginia Supreme Court was a decision on the merits. *Sutherland v. Swannanoa Corp.*, 189 Va. 149, 154, 52 S.E.2d 92, 95 (1949).

[4] The Virginia Supreme Court reaffirmed these portions of its first opinion in the opinion from which this writ of certiorari is sought. The last line of its second opinion states that "we reaffirm our prior decision in all respects." Petition for Certiorari, App. A at 5a. And the two preceding paragraphs, as elaborated below, can only be read as referring to the "state-law ground" portions of its first opinion.

Michigan v. Long to resolve ambiguous references to federal law in state court opinions. *See Coleman v. Thompson*, 111 S.Ct. 2546, 2558-59 (1991). There is no ambiguity here about the state-law grounds on which the state court relied in this part of its original opinion.

Second, what the Virginia Supreme Court is saying – and note that the cases on which it relies were decided long before the tax years at issue here – is that the remedy sought by these Petitioners under Va. Code § 58.1-1826 can be asserted only for assessments that were "erroneous and improper" under established law at the time of the assessment. What *Perkins* and *Capehart* mean is that the state law remedy under § 58.1-1826 is unavailable in a case like the present one, irrespective of the fact that the Federal Constitution may have been violated at the time the assessment was made. As has been pointed out above, the same could be said of a suit brought today for a refund of a tax "unconstitutionally" imposed and collected from a retired federal employee in 1942. In that case, the analysis presumably would be that the statute of limitations policy expressed in Va. Code § 58.1-1825 (three years) would stand as a legitimate state-law procedural barrier to compensatory relief for the violation of federal law. What we have here is really the same thing. The Virginia Supreme Court has enforced a limitation on the remedy sought by these Petitioners that has been recognized in state law since 1973. It, just as would a statute of limitations, forecloses compensatory relief for previously paid taxes that are invalidated by the recognition of a new principle of law. Both principles of state law are grounded in policies of respose that recognize legitimate state interests in fiscal stability and planning. Neither is it unfair to people in the Petitioners' shoes, it

should be added, because in both cases – the case of a statute-of-limitations foreclosure and the case of an unavailable remedy under Va. Code § 58.1-1826 – alternative remedies were available at an earlier day under which they could have protected their rights.

Third, it is of course within the competence of this Court to examine principles of state law such as these in order to determine their acceptability under appropriate federal standards. We will have more to say about this point immediately below. But what by longstanding tradition is *not* within the competence of this Court is to challenge state courts on their determination of the meaning and application of state law. It is for the Virginia Supreme Court to say what state law is, and that Court has done so in this case. That premise can be challenged on federal grounds, and we now turn to how that challenge plays out in the present case.

4. The Adequacy and Independence of the State Ground.

This case turns, in the language of this Court's adequate and independent state ground doctrine, on whether principles of federal law have been evaded or undermined by the application of state law in the courts below. Within the framework of accepted doctrine, the question is whether the state law ground that supports the judgment below is either "inadequate" to foreclose reaching the federal questions or "not independent" of appropriate federal principles.

There can be no argument here that the conclusions of state law on which the decision below rests are "not independent" of federal law. No federal cases are cited in

this portion of the state court opinion, no federal law discussed. As noted above, there is no ambiguity here of the sort that concerned the Court in *Michigan v. Long*.

Substantial questions could be raised, perhaps, about the "adequacy" of the state ground advanced in the court below. It could be argued, for example, that due process requires the states to afford a backward looking remedy in at least some cases of unconstitutional taxation. This Court held as much in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 110 S. Ct. 2238 (1990) (*"McKesson"*). Respondent has no quarrel with *McKesson*, nor with the principles that underlie it. But that case is dramatically different from the situation here.

McKesson establishes that prospective relief alone is not adequate in a case where it was entirely foreseeable at the time of enactment of a challenged state tax statute that the tax in question would be contested and invalidated. *McKesson* addressed the state interest in sound fiscal planning in the following passage:

> [W]e do not find this concern weighty *in these circumstances*. A State's freedom to impose various procedural requirements on actions for postdeprivation relief sufficiently meets this concern with respect to future cases. The State might, for example, provide by statute that refunds will be available only to those taxpayers paying under protest or providing some other timely notice of complaint; execute any refunds on a reasonable installment basis; enforce relatively short statutes of limitation applicable to such actions; refrain from collecting taxes pursuant to a scheme that has been declared invalid by a court or other competent tribunal pending further review of such declaration on appeal; and/or place challenged tax payments into an

> escrow account or employ other accounting devices such that the State can predict with greater accuracy the availability of undisputed treasury funds. The State's ability in the future to invoke such procedural protections suffices to secure the State's interest in stable fiscal planning when weighed against its constitutional obligation to provide relief for an unlawful tax.

110 S. Ct. at 2254-55 (emphasis added). The Court observed that "in the present case, Florida's failure to avail itself of certain of these methods of self-protection weakens any 'equitable' justification for avoiding its constitutional obligation to provide relief" and added that, in any event, Florida had ample notice that the statute in litigation in *McKesson* was potentially defective when measured against constitutional standards. *Id.* at 2255. From this it followed that Florida's " 'equitable' justification" for withholding relief was without basis.

The point to be made here is that Virginia has availed itself of certain of these methods of "self-protection." It adopted the limitation on its state refund statute reflected in *Perkins* and *Capehart* in 1973, long before the instant litigation was filed. Petitioners were on notice at the time they paid the taxes to which they now object that refunds would not be available under Va. Code § 58.1-1826 based upon subsequent legal developments.

And it does not follow from the reasoning of *McKesson*, moreover, that the ability of the states to engage in sound fiscal planning is an illegitimate consideration in *all* cases where state taxes have been found to violate federal law. Florida's ability "in the future" to invoke procedural protections of the sort suggested by the Court in *McKesson* sufficed to secure its interest in sound fiscal planning in that case because it was clearly

on notice that the tax in question was of doubtful legality when that tax was adopted.[5] Florida, in other words, could have adequately protected its fiscal interests by paying more attention to this Court's constitutional precedents. The same point could not in fairness be made in a case where both the State and the taxpayer have had no reason to question the legality of a tax for 30 or 40 or 50 years. In such a case, it is submitted, federal due process would not be violated by a restriction of relief to prospective invalidation of the tax.

There should be room in the applicable principles of federal due process, in other words, for consideration of the reliance interests of state governments based upon reasonable assumptions about the stability of law over time. A related issue recently arose in *Swanson v. Powers*, 937 F.2d 965 (4th Cir.), *petition for cert. filed*, 60 U.S.L.W. 3344 (U.S. Oct. 21, 1991) (No. 91-666). The plaintiffs in that case sued the former North Carolina Secretary of Revenue for $140 million for her actions in collecting

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[5] The Court was explicit about this rationale in *McKesson*, 110 S. Ct. at 2257, when it gave two reasons for the conclusion that "the State's interest in financial stability does not justify a refusal to provide relief." The first was that "the State here does not and cannot claim that the Florida courts' invalidation of the Liquor Tax was a surprise. . . . " The second was that Florida could take procedural steps in the future "against any disruptive effects of a tax scheme's invalidation."

The situation now before the court is importantly different. The decision calling the Virginia tax statute into question was a surprise. And steps that Virginia – and other states now facing huge tax refund claims – can take "in the future" are of little value to mitigate the disruption and financial instability now faced based on events that have already occurred. Legitimate steps they have taken to protect these interests in the past, moreover, should be respected.

North Carolina's version of the same tax at issue in *Davis*. The suit was brought in federal court under 42 U.S.C. § 1983 and was appealed to the Fourth Circuit on the question whether the former North Carolina Secretary of Revenue was entitled to qualified immunity. Judge J. Harvie Wilkinson, writing for the court, held she was: "We believe that to hold Secretary Powers liable because she failed to accurately predict the outcome of the *Davis* decision would work a miscarriage of justice. . . . " 937 F.2d at 967. The court went on to say:

> Only violations of those federal rights "clearly recognized in existing case law" will support an award in damages under 42 U.S.C. § 1983. Public officials must be able to discharge their public duties free of an omnipresent fear of § 1983 liability. Only in that way can we be sure that government can continue to function efficiently while liability will fall properly upon only "the plainly incompetent or those who knowingly violate the law."
>
> This tolerance for a range of reasonable public actions is particularly important for those who must interpret often imprecise or incomplete legal precedent. . . .
>
> In interpreting qualified immunity, then, we must appreciate the fact that the direction of the law may be difficult to ascertain. Thus, although public officials may be "charged with knowledge of constitutional developments, [they] are not required to predict the future course of constitutional law." . . . The requirement, after all, is that the law be clearly established, not simply possibly established or even probably established. Since qualified immunity is appropriate if reasonable officers could disagree on the relevant issue, it surely must be appropriate when reasonable jurists can do so.

937 F.2d at 967-68 (citations omitted). The plaintiffs argued in *Swanson*, as the Petitioners argue here, that nothing "new" was established in *Davis*. Judge Wilkinson responded:

> We disagree. Secretary Powers was enforcing a long-standing statute that was similar to enactments elsewhere. The most pertinent judicial decisions had upheld comparable taxing schemes and the doctrine of intergovernmental tax immunity was, at best, ambiguous. We decline to proclaim in hindsight after the *Davis* decision, that the unconstitutionality of differential tax exemptions had been clear all along.

937 F.2d at 968.

One of the premises of the judicial doctrine of qualified immunity under § 1983 is that it is unfair to hold public officials accountable for unforeseeable developments in constitutional law. The doctrine builds an element of fault into the principles that determine the accountability of public officials for the constitutional harms they inflict. What the Virginia Supreme Court has done in its decision below, and in the body of state law precedent dating from 1973 on which the decision below is grounded, is essentially the same thing. It has built an element of fault into the refund remedy provided by Va. Code § 58.1-1826. It puts upon taxpayers the burden of raising "new" constitutional arguments before they pay the tax, by limiting refund actions to cases where the basis for the refund was reasonably predictable based on established law. It is no less unfair to the citizens of Virginia to require them to pay $440 million to these Petitioners and other similarly situated taxpayers than it would have been to require Secretary Powers to pay comparable taxpayers in North Carolina. Both situations

call, in Judge Wilkinson's words, for "tolerance for a range of reasonable public actions." 937 F.2d at 968. The Virginia Supreme Court built that tolerance into its state-law remedial structure.

5. Procedural Posture of the Case.

The state-law ground advocated by the Virginia Supreme Court in support of its judgment below is fully adequate under appropriate federal standards. It follows from the normal application of accepted principles that this Court should not reach the merits of the federal question presented. For this reason alone, the writ of certiorari should be denied.

The Petition for Certiorari has chosen to ignore the state-law basis for the decision below. Petitioners have not argued that the state ground on which the decision rests is either "inadequate" or not "independent." But there is yet another reason why the writ should be denied.

While Petitioners seem to argue in this Petition that the failure of the State to supply a retrospective refund remedy would be a violation of due process, this is not the stage of this litigation where such questions should be entertained by this Court. No such questions were passed upon by the Virginia Supreme Court. Such questions can be addressed when they are properly presented in a case in which they have been properly litigated and decided in the lower courts.

Moreover, as the Commonwealth argued below, the "due process" issue now asserted by Petitioners is not a clean "remedy or no-remedy" question. Petitioners sought post-deprivation relief under Va. Code § 58.1-1826. They are not, as the Virginia Supreme Court held below, entitled to

that remedy. They were, however, entitled at another time on another day to another remedy. What they failed to do was pursue an avenue of predeprivation relief that was open to them under Virginia law.

We repeat here the argument we made below:

A. In Virginia, a taxpayer is entitled to challenge a tax assessment in a pre-deprivation (*i.e.*, prior to payment) procedure set forth in §§ 58.1-1821 and 58.1-1822. Section 58.1-1821 provides:

> Any person assessed with any tax administered by the Department of Taxation may, within ninety days from the date of such assessment, apply for relief to the Tax Commissioner. Such application shall be in the form prescribed by the Department, and shall fully set forth the grounds upon which the taxpayer relies and all facts relevant to the taxpayer's contention. The Tax Commissioner may also require such additional information, testimony or documentary evidence as he deems necessary to a fair determination of the application.
>
> On receipt of a notice of intent to file under this section, the Tax Commissioner shall refrain from collecting the tax until the time for filing hereunder has expired, unless he determines that collection is in jeopardy.

Section 58.1-1822 provides:

> If the Tax Commissioner is satisfied, by evidence submitted to him or otherwise, that an applicant is erroneously or improperly assessed with any tax administered by the Department of Taxation, the Tax Commissioner may order that such assessment be corrected. If the assessment exceeds the

> proper amount, the Tax Commissioner shall order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid into the state treasury, and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the Tax Commissioner shall order that the applicant pay the proper taxes. He shall refund to the taxpayer any exempt funds which have been improperly collected. The Tax Commissioner shall refrain from collecting a contested assessment until he has made a final determination under this section unless he determines that collection is in jeopardy.

B. Virginia Regulation § 630-1-1820 provides that § 58.1-1821 "may be used to protest any and all issues connected with an assessment." While § 58.1-1821 does not require a formal hearing, a taxpayer may present his position both in writing and in person. Va. Reg. § 630-1-1821 (Application under § 58.1-1821 "will be handled within the Department [of Taxation] in the manner best determined by the Commissioner to resolve the dispute, which may include submission of additional documents and memoranda, further audit, holding a conference with the taxpayer or the taking of testimony."). Under precedent established by this Court, this procedure satisfies the demands of due process for a pre-deprivation administrative proceeding. *Mathews v. Eldridge*, 424 U.S. 319 (1976); *Arnett v. Kennedy*, 416 U.S. 134 (1974); *Goldberg v. Kelly*, 397 U.S. 254 (1970).

C. Applying this analysis to the facts presented here, it is clear that Virginia's administrative predeprivation remedy satisfies due process. Section 58.1-1821 allows the taxpayer to

set forth the grounds for contesting the tax, provides for the presentation of any evidence necessary to a fair determination of the action, and permits the exoneration from payments of any amount erroneously or improperly charged. Unless collection is in jeopardy, the Tax Commissioner must refrain from collecting a contested assessment under the statute.

D. Plaintiffs had a clear, meaningful, predeprivation opportunity to challenge the validity of the tax provisions relating to pensions. They chose not to do so and, under *McKesson*, must be considered to have paid the challenged taxes voluntarily. Under the rule of *McKesson*, due process does not now require additional post-deprivation procedure with backward looking relief.

We do not restate these arguments here in the view that this Court should now resolve the questions of state and federal law which they raise. But they do reinforce the wisdom of this Court's practice that it will not consider issues that have not been fully ventilated below. There are complex questions of state law intertwined in any resolution of whether denial of a remedy under § 58.1-1826 is a violation of federal due process. But the procedural posture of the present case makes it unnecessary for this Court to reach those issues now. The Petitioners did not challenge the adequacy of the predeprivation remedy in the Virginia Supreme Court, and accordingly, the questions of state law on which any resolution of the federal due process issue would turn were not presented by the Petitioners in the proceedings below.

6. The Relevance of *Beam*.

Finally, the arguments made here must be considered in light of the premises and structure of *Beam*. The Virginia Supreme Court has thoughtfully and carefully considered this Court's pronouncements in *Beam*, and its decision on remand is fully consistent with the requirements of that case.

The question in *Beam* was at what analytical points the retrospectivity of a Supreme Court decision could be considered. *Beam* divided the relevant landscape into two kinds of issues, choice-of-law questions and remedy questions. 111 S. Ct. at 2443.

The choice-of-law issue involved the operative substantive principles that would determine the federal rights sought to be asserted. There were three options: complete retroactivity, complete prospectivity, and selective prospectivity. What *Beam* did was eliminate the third option. 111 S. Ct. at 2446. Supreme Court decisions are not going to be selectively prospective in the sense that they apply to the parties before the Court but not to others whose facts arose before the decision.

What *Beam* did not do is select between the other two options; complete prospectivity and complete retrospectivity are still possible outcomes after *Beam*. 111 S. Ct. at 2448. As this result would apply to the present case, this means that it remained open for the Virginia Supreme Court to hold, as it did, that *Davis* was to be applied in a purely prospective manner. That is the only federal question decided in the opinion below.

What is even more important to the ultimate issues in this case is another point – the question of available remedies – not resolved in *Beam*. As noted by the Justices of the Virginia Supreme Court (Petition for Certiorari,

App. A at 5a), Justice Souter's opinion stated at the end of part III that "nothing we say here precludes consideration of individual equities when deciding remedial issues in particular cases." 111 S. Ct. at 2448. He elaborated at the beginning of Part IV of his opinion:

> The grounds for our decision today are narrow. They are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata. We do not speculate as to the bounds of pure prospectivity.
>
> Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with, or their consideration obviated by, issues of state law." *Bacchus*, 468 U.S., at 277. Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal.

111 S. Ct. at 2448.

Here, unlike *Beam*, remedial issues were considered below. The Virginia Supreme Court accepted the invitation in *Beam* to "consider[] . . . individual equities when deciding [the] remedial issues in [this] particular case[]." 111 S. Ct. at 2448. It did so by applying established precedent that had anticipated the issue, and that had

resolved the matter under Virginia law in 1973. Petition for Certiorari, App. C at 15a-16a. And in the last three paragraphs of its opinion, written in response to this Court's reconsideration order, the Virginia Supreme Court reinforced these conclusions from its first opinion by referring to precisely the above quoted passages in the *Beam* decision. Petition for Certiorari, App. A at 5a.

What the Virginia Court did was entirely consistent with *Beam*. And since the issues on which the decision below turns involve questions of state law that have not been challenged in the Petition for Certiorari, the Petition should be denied.

7. The Military Retirees.

The Petitioners make one other argument that requires a response, though it can be brief. They argue that the Commonwealth's effort to distinguish between civil service retirees and military retirees "presents an independent ground necessitating plenary review by the Court." Petition for Certiorari at 12. It is clear that certiorari should not be granted on this issue in this case. And the fact that this issue is even raised in the Petition suggests that a limited grant of the writ would be appropriate should the Court be inclined to hear the case on other issues.

The reason certiorari on this issue is inappropriate is straightforward. The Court has granted certiorari in a case which clearly presents this issue. *Barker v. Kansas*, 249 Kan. 186, 815 P.2d 46, *cert. granted*, 60 U.S.L.W. 3402 (U.S. Dec. 3, 1991) (No. 91-611). Moreover, the Court should not hold this case pending resolution of *Barker* because Petitioners did not raise this issue below, nor did the Virginia Supreme Court address the issue. It is true

that *the Commonwealth* argued in the trial court that there was a relevant difference between how the *Davis* decision should be applied to civil service retirees and how it should be applied to military retirees (if it is to apply at all to taxable events that concluded before the decision). But it is also true, as the Petitioners conceded in their previous Petition for Certiorari (Petition for Certiorari, No. 90-1685, p. 19), that "[t]he court below did not reach this argument. . . . " They did not acknowledge then, as they do not now, that *they* did not raise the argument they now wish to make in the trial court below, thus precluding review by the Supreme Court of Virginia. It is surely novel to assert that this Court should grant certiorari to reject an argument made by the prevailing party below, that was neither adverted to nor passed upon by the court below, that was in no sense necessary to the judgment below, that was in fact made unnecessary by the basis for the decision below, and that raises an issue never raised by the Petitioners until they reached this Court. Petitioners would give a new dimension to the "advisory opinion" concept if they were successful in obtaining a grant of the writ on this issue.

CONCLUSION

In the end, there is only one federal question presented by this Petition for Certiorari that is of sufficient importance as a general matter to warrant a grant of the writ. That question – whether *Davis* can be applied in a purely prospective fashion – may need to be resolved by this Court at some juncture. But traditional principles governing the jurisprudence of this court suggest that the Court should do so in a case where resolution of the

issues makes a difference to the outcome of the case. Principles that counsel against the rendering of advisory opinions also counsel against granting the writ in this case. This case involves an asserted federal right sought to be enforced through an unavailable state cause of action. The Petition for Certiorari suggests no ground upon which the unavailability of the state cause of action offends or is in any way inconsistent with federal interests. Were the Court to uphold the existence of the federal right as Petitioners ask, the case still would reach the same result because the Petitioners have not challenged the state ground that fully supports the decision below. The only effect of granting certiorari will be to require yet another decision by this Court, followed by yet another decision on remand by the Virginia Supreme Court, followed by yet another round of certiorari proceedings in this Court – all in a case where the ultimate outcome is already plain. It is time for these proceedings to come to an end.

Respectfully submitted,

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Virginia

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BRIEF *AMICI CURIAE* ON BEHALF OF THE ARIZONA AND WISCONSIN STATE FEDERATIONS OF CHAPTERS OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES IN SUPPORT OF PETITIONERS

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QUESTIONS PRESENTED

1. Whether this Court's decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

2. Whether the doctrine of intergovernmental tax immunity and 4 U.S.C. § 111 prohibit a state from taxing pensions of military retirees while exempting from taxation the pensions of its own retired employees.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Petition for a Writ of Certiorari to the Supreme Court of Virginia

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BRIEF *AMICI CURIAE* ON BEHALF OF THE ARIZONA AND WISCONSIN STATE FEDERATIONS OF CHAPTERS OF THE NATIONAL ASSOCIATION OF RETIRED FEDERAL EMPLOYEES IN SUPPORT OF PETITIONERS

Pursuant to Rule 37.2 of the Rules of this Court, the parties have consented to the filing of this brief.

INTEREST OF *AMICI*

Amici are the Arizona and Wisconsin State Federation of Chapters of the National Association of Retired Federal Employees ("NARFE"). NARFE is a nonprofit, incorporated association having its principal place of business in Washington, D.C. From its original fourteen charter members, NARFE has grown to a membership now exceeding 500,000 federal annuitants (retirees and survivors) living throughout the fifty states, Puerto Rico, the Canal Zone, the Republic of the Philippines, and

various foreign countries. NARFE has been a major advocate in maintaining the integrity of the federal government's civilian retirement systems and has been directly involved, through lobbying and related activities, in all legislative and executive changes in these systems over the past six decades.

NARFE has concerned itself with issues affecting the aged and aging, and in particular those issues that affect federal annuitants. NARFE's goal is to identify issues of particular importance to federal annuitants, to inform them, through its Newsletter and the state and local chapter network, of these issues, and to act upon these issues to further the members' common goals. NARFE also assists federal annuitants in obtaining benefits to which they may be entitled under the retirement laws by interacting with various federal agencies and private entities on such matters as federal annuities and health and life insurance benefits. The Arizona and Wisconsin State Federations of Chapters are involved with implementing NARFE's policies in the States of Arizona and Wisconsin, respectively, and coordinating local activities.

The State of Virginia and at least twenty-two other states taxed the federal retirement benefits of federal annuitants while exempting from state taxation the retirement benefits of state annuitants. This disparate tax treatment is in violation of 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity.

The question presented in this case—whether the refunds of state income tax imposed in violation of 4 U.S.C. § 111 may be denied through a prospective-only application of *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989)—is vitally important to *amici*. If a prospective only application of *Davis* is applied, these federal annuitants will suffer economic harm. Thus, *amici* have a compelling and vital interest in the proper resolution of the questions presented.

REASONS FOR GRANTING THE WRIT

This case raises important questions regarding the propriety of states retaining taxes imposed and collected from their citizens in violation of the Constitution of the United States and 4 U.S.C. § 111. *Amici* ask that this Court grant certiorari to reverse the decision of the Supreme Court of Virginia. The Court below presumed that it had the authority to decree that a decision striking down state taxes on constitutional grounds may be applied prospectively only. *Amici* contend that the conclusion of the court below is contrary to the plain holding of this Court in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). Upon remand from this Court, the Virginia Supreme Court held that this Court did not apply the rule retroactively to Mr. Davis, noting that the "Court made no such ruling in *Davis*." *Harper v. Virginia Dep't of Taxation*, No. 900792 (Nov. 8, 1991).[1]

In *Davis*, the Court invalidated Michigan's discriminatory tax scheme as in effect during the tax years 1979 through 1984 and applied its decision to the litigants before it stating that "to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." 489 U.S. at 817 (citing *Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239, 247 (1931)).[2] Having accorded Mr. Davis the benefit of the decision in *Davis*, it necessarily follows that the holding must be applied "to all others not barred by procedural requirements or res judicata." *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2448 (1991).

However, even assuming *amici* misread this Court's decision in *Davis* and its judgment in *Beam*, *amici* respectfully submit that the result reached by the Supreme Court

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[1] *See* Petition at 4a.

[2] The very issue resolved in *Davis* was that "federal retirement benefits [for the years 1979 through 1984] were 'not legally taxable under the Michigan Income Tax Law.'" *Davis*, 489 U.S. at 806-07.

of Virginia was, nonetheless, clearly erroneous. In view of the important federal interests implicated by this case, review by this Court is warranted to ensure that the encroachment upon federal power by the court below is not allowed.

I. A STATE COURT DOES NOT HAVE THE POWER TO CHANGE THE EFFECTIVE DATE OF A CONGRESSIONAL ENACTMENT

In *Davis v. Michigan Dep't of the Treasury*, 489 U.S. 803 (1989), this Court construed the "plain language" of 4 U.S.C. § 111 and concluded that the "statute leaves no room for doubt" that federal retirement benefits "are subject to § 111." *Id.* at 808-09. However, in the decision below, the Supreme Court of Virginia, motivated solely by parochial concerns and ostensibly relying on its view of the prospectivity doctrine, apparently believed that it had the unfettered power to change the effective date of this unambiguous federal statute. The practical consequence of its decision, if permitted to stand, is that 4 U.S.C. § 111 is effective for all tax years after *1988* in Virginia, whereas the statute has been effective throughout the rest of the country since January 1, 1939. *See* Public Salary Tax Act of 1939, Ch. 59, § 4. (App. A at 1a). *See also Meredith v. State Tax Commission*, 163 Or. 305, 312-13, 96 P.2d 1082 (1939) (recognizing that the effective date of the Public Salary Tax Act as enacted by Congress is controlling.).

Within the last two weeks, a trial court in the State of Arizona has been persuaded to ignore clearly established state refund statutes and long-standing administrative refund practices and ruled, in reliance upon the decision below, that for years prior to *1991* a state tax scheme which discriminated in favor of current state employees and against current federal employees in violation of 4 U.S.C. § 111 was not "unconstitutional." *See Kerr v. Waddell*, TX 89-01153 (Arizona Tax Court, Nov.

26, 1991). In addition, in virtually all of the states where *Davis* litigation is not yet final, state appellate courts are being urged to adopt the decision below as dispositive constitutional law.[3]

The position urged by the defendants below and reaffirmed by the Supreme Court of Virginia upon remand from this Court is unprecedented. In fact, it is fundamentally inconsistent with settled notions of federalism and state courts' obligations under the Supremacy Clause. Moreover, given the hysteria created by the exaggerated claims of the fiscal burden advanced by the Attorneys General of several states, the jurisprudence of several states has already been infected by the adoption of the rational of this decision.[4]

The decision below is irreconcilable with this Court's landmark decision of *M'Culloch v. Maryland*, 17 U.S. 415 (1819). The Supreme Court of Virginia does not have the "power" to substitute its determination for that of Congress:

> [T]he States have no power, by taxation or otherwise, to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress to carry into execution the powers vested in the general government.

Id. at 439. A unanimous Court recently reaffirmed this principle in the context of 42 U.S.C. § 1983, noting that:

> The policy of the Federal Act was to be considered 'the prevailing policy in every state' which the state court could not refuse to enforce 'because of concep-

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[3] *See, e.g.*, State defendants' letter brief of November 14, 1991 in *Duffy v. Wheeler*, 148 Misc. 2d 459, 555 N.Y.S.2d 543 (N.Y. 1990), *appeal docketed*, No. 90-07800 (2d Dept. 1991).

[4] *See, e.g., Sheehy v. Department of Revenue*, No. 90-450, 1991 WL 238253 (Mont. Nov. 14, 1991); *Swanson v. North Carolina*, 407 S.E.2d 791 (N.C. 1991), *aff'd on reh'g*, No. 64PA91-Wake (Dec. 6, 1991).

> tions of impolicy or want of wisdom on the part of Congress in having called into play its lawful powers.'

Howlett v. Rose, 110 S. Ct. 2430, 2442 (1990) (citations omitted). And again last term, the Court, in the context of applying another unambiguous statute, instructed that " 'the sole function of the court is to enforce it [the statute] according to its terms.' " *West Virginia Univ. Hosp., Inc. v. Casey*, 111 S. Ct. 1138, 1147 (1991) (citations omitted).

Indeed, if the decision below were to stand, the resulting anomaly in the law would be breathtaking. In *Fleming v. Fleming*, 264 U.S. 29 (1924), this Court ruled with respect to a state court's construction of a state statute that:

> The effect of the subsequent decisions is not to make a new law, but only to hold that the law always meant what the court now says it means. The court has power to construe a legislative act, but it has no power by change in construction to date its passage as a law from the time of the later decision.

Id. at 31-32. Under this settled view, the Supreme Court of Virginia would be powerless to change the effective dates of legislation of its own legislature, but yet, motivated by uniquely parochial interests, would have the power, within Virginia, to change the effective dates of legislation passed by Congress. However, as this Court has ruled:

> The laws of the United States are laws in the several States, and just as much binding on the citizens and courts thereof as the State laws are.

Claflin v. Houseman, 93 U.S. 130, 136 (1876).

In a context analogous to the issues presented here, this Court has previously held that it does not possess the power which the Supreme Court of Virginia exercised below. In *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7 (1983), this Court invalidated a Hawaii stat-

ute that imposed a tax on gross income of airlines operating within the state because it had been pre-empted by Congress.[5] In so holding, this Court noted that it was bound by the determination of Congress:

> We acknowledge that our interpretation of § 1513(a) may result in the disruption of state systems of taxation; we are, however *bound* by the plain language of the statute.

Id. at 14 n.10 (emphasis added).[6]

The important issue of federalism decided by the court below presents a significant danger, the impact of which transcends the interests of federal retirees of Virginia and the hundreds of thousands of federal retirees whose rights under *Davis* are currently the subject of ongoing litigation in approximately eighteen states. The real danger that the holding below presents is that it will be readily extended by Virginia and other states to limit states' obligations to comply with Congressional enactments involving the general welfare. However, no court possesses the "veto" power which the Supreme Court of Virginia exercised below. As this Court held in *Tennessee Valley Auth. v. Hill*, 437 U.S. 153 (1978):

> Once the meaning of an enactment is discerned and its constitutionality determined, the judicial process

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[5] Prior pronouncements of this Court in the context of federal legislation involving a conditional waiver of intergovernmental tax immunity indicate that, absent a strict adherence to the requirements of such legislation, state tax enactments will be invalidated. *See, e.g., Chase Manhattan Bank, N.A. v. Finance Admin.*, 440 U.S. 447 (1979).

[6] *See also Commissioner of Immigration v. Gottlieb*, 265 U.S. 310, 312 (1924) ("The case, as the evidence shows, is one of peculiar and distressing hardship, and it is not unnatural that any appropriate canon of construction should be laid hold of to justify a conclusion favorable to respondents. But if the plain words of the statute are against such a conclusion, leaving no room for construction, the courts have no choice but to follow it, without regard to the consequences.").

> comes to an end. We do not sit as a committee of review, nor are we vested with the power of veto.

Id. at 194-95.

Amici respectfully submit that this Court's carefully articulated retroactivity decisions of the last two terms have no application, in the first instance, in a case involving an unambiguous statute, the overall meaning of which is "unmistakable." *Davis*, 489 U.S. at 810. It was error for the court below, under the guise of the prospectivity doctrine, to change the considered decision of Congress, which carefully weighed the equities in establishing the January 1, 1939 effective date of 4 U.S.C. § 111. *See* Public Salary Tax Act of 1939, Title I, § 4; Title II, § 201 (App. A at 1a-2a). Consistent with the command of the Supremacy Clause and *M'Culloch v. Maryland*, a grant of the petition for writ of certiorari in this case will permit this Court to resolve the uncertainty created in the law of the several states as the result of the decision below.

II. ALTERNATIVELY, ASSUMING THIS COURT DETERMINES THAT THE PLURALITY APPROACH OF *AMERICAN TRUCKING ASS'N* MAY BE APPLIED TO A CONGRESSIONAL ENACTMENT, A DETERMINATION OF PROSPECTIVITY MAY ONLY BE UPHELD UPON A MEANINGFUL ANALYSIS OF THE SECOND AND THIRD PRONGS OF *CHEVRON*

The plurality observed in *American Trucking Ass'n v. Smith*, 110 S. Ct. 2323 (1990), that the "policy concerns involved" in a decision delineating the scope of liability under a federal statute "are quite distinct" and provide little guidance for determining the fairest way to apply the Court's decisions in the context of the dormant Commerce Clause doctrine. *Amici* respectfully submit that the application of the prospectivity test reflected in the plurality decision of *American Trucking Ass'n* is particularly inappropriate to a case such as this where Congress has made the express policy decision as to the statute's effective date. However, assuming this Court is persuaded that it should apply the *American Trucking Ass'n* plurality test and assuming further that the threshold test is somehow deemed satisfied, this Court should determine the appropriate parameters for prongs two and three of that test when applied in the context of a state personal income tax where the interests of the United States, as well as elderly citizens, are implicated.[7]

Setting aside the issue of whether the first prong was correctly determined, the court below summarily concluded that, because the state statute at issue was repealed prospectively, this prong had been satisfied. (Pet. App. C at 12a).[8] This summary observation can hardly be deemed adequate.

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[7] As cogently pointed out in the original petition in this case, the determination of the Supreme Court of Virginia on the first prong appears to be nothing more than a bald conclusion. *See* Petition No. 90-1685 at 9-13. A review of this Court's opinion in *Davis* clearly reflects that the party who sought to overrule "clear past precedent" was not the taxpayer but the Michigan Department of the Treasury. *Davis*, 489 U.S. at 814-15. In addition, under this Court's reasoning in *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990) and *National Mines Corp. v. Caryl*, 110 S. Ct. 3205 (1990), even if *Davis* is subject to the prospectivity test, it still should be applied retroactively. *See South Carolina v. Baker*, 485 U.S. 505, 520 n.10 (1988) (the law has always been that Congress has the power to enact statutes immunizing those with whom it deals from state taxation even if the doctrine would not otherwise confer immunity.). *See also* note 8, *infra*.

[8] In addressing the first prong, it apparently was of no moment to the court below that Congress specifically provided in the Public Salary Tax Act of 1939 that the Act was to be construed by reference to the Internal Revenue Code. *See* Sec. 206. (App. A at 4a). Under the Code, it has been clearly established for almost 70 years that pensions for government service are governed by the doctrine of intergovernmental tax immunity. *See* I.T. 1607, II-1 C.B. 71 (1923) ("Inasmuch as salaries and wages received by officers and employees of the State are exempt from taxation . . . it is held

This Court should take the opportunity to frame the duty of a court to engage in a meaningful inquiry under this prong. Had such an inquiry been undertaken in this case, the court below would have been forced to conclude that the purpose of the rule could be furthered only by retrospective operation. The court's failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule.

In *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466 (1934), the Court observed that:

> [The] application [of the intergovernmental tax immunity doctrine] does not depend upon the amount of exaction, the weight of the burden, or the extent of the resulting interference with sovereign independence. Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree . . . . Its right application is essential to the orderly conduct of the national and state governments and the attainment of justice as between them.

Id. at 471.

For over four decades, Virginia reduced its employment costs at the expense of the federal treasury. *See Davis*, 489 U.S. at 815 n.4. In addition, during that same period of time, it misappropriated substantial federal revenues by virtue of the discriminatory tax imposed upon federal retirees. These state exactions were deducted

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that the retirement allowance given employees of the State of New York under the New York State Employees' Retirement System represents compensation for past services rendered and is exempt from taxation."); I.T. 2669, XII-1 C.B. 68 (1933) (pensions paid to person who rendered services as an officer or employee of a State or political subdivision thereof "represent compensation paid for past services rendered, and since the compensation in such cases was exempt from Federal income tax the pensions are also exempt from Federal income tax."); I.T. 3364, 1940-1 C.B. 19 (holding that municipal pensions were not taxable prior to the effective date of the Public Salary Tax Act, but were taxable thereafter.). *See also* note 9, *infra*.

by numerous federal retirees under 26 U.S.C. § 164, directly reducing federal income tax collections for each of those years. (App. B at 6a).[9] Refunds of these taxes now will enable the federal government to recover part of the federal revenues misappropriated by Virginia in past years. Under the Tax Benefit Doctrine and section 111 of the Internal Revenue Code, any refund ordered will be subject to federal tax in the year received. *Id.* Consequently, the refusal of the Supreme Court of Virginia to order refunds has actually resulted in a new violation of 4 U.S.C. § 111.

With respect to the third prong, the court's analysis is almost nonexistent. (*See* Pet. App. C at 12a-14a). Its analysis consisted solely of the alleged financial burden upon the state. The relevant equities are far broader in this case and generally, in the context of a personal income tax case, should differ significantly from those weighed under a Commerce Clause challenge.

First, the court below made no effort to quantify the windfall that Virgina received during the forty-plus years this unlawful scheme was in effect.[10] Common sense

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[9] In startling contrast to the State of Virginia, during this same period, the Internal Revenue Service has consistently adhered to the doctrine of intergovernmental tax immunity and the provisions of the Public Salary Tax Act of 1939 by recognizing that the part of *current* pension payments received by state and local retirees, which is attributable to employer contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Act. *See* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28.

[10] Indeed, it is surprising that the State of Virginia even urged that the equities favored no relief. For its size and contribution to the federal fisc, Virginia's economy for years has been the beneficiary of a generous federal government. Recent statistical data reflect that in fiscal year 1989, the Department of Defense, alone, spent over $15 billion in the state. *See* Department of Defense ATLAS/DATA ABSTRACT FOR THE UNITED STATES AND SELECTED AREAS—FY 1989. (App. C at 9a).

suggests that the amount of taxes exacted for years before 1985 exceeds by several times any present refund obligation. Second, Virginia did not hesitate to accept that part of the Public Salary Tax Act of 1939 which benefitted its parochial interests. Under Title II of the Act, Virginia's retirees, as well as its then current employees, enjoyed total immunity from the federal income tax for all years prior to 1939. *See* Public Salary Tax Act of 1939, Ch. 59, Title II. (App. A at 3a). Having accepted the benefits of the Act, equity compels that Virginia now accept its burden.

Most significantly, the court failed to analyze the equities and reliance interests of its federal retirees, many of whom are elderly. Unlike *American Trucking Ass'n*, the taxpayers here are not sophisticated multi-state business enterprises. They are average, law-abiding citizens who complied with the mandates of the Virginia law. For purposes of weighing the equities, they should not now be penalized by Virginia for complying with its laws. Moreover, it is totally inappropriate for a court to penalize an elderly citizen because that citizen could not afford to challenge that which the State should have known was, at best, suspect.[11] With respect to Virginia's tax collections

[11] As noted in the now final decision of Judge Hererra in the *Davis*-related case of *Burns v. Shaw*, No. 89-1314(c) (N.M. Santa Fe County, Apr. 5, 1990):

> [T]he State . . . argues that the decision in *Davis* was not foreshadowed because it has gone unchallenged. Such an analysis begs the question. The State . . . cannot sit by and wait until a law is challenged without an independent analysis of whether or not it is legal. What rationale did the State have for treating Federal retirees and State retirees differently? . . . The operative question should not be whether the statutory scheme was challenged, relying on actions by some unidentified parties, but whether it was reasonable for the State . . . to assume that it was constitutionally [sic] permissible to treat State retirees differently from Federal retirees. Such a distinction defies logic and could have been anticipated by the State . . . even without intervention from the United States Supreme Court. An *objective* analysis would have led the State . . . to conclude that the distinction was suspect and incorrect.

Id. slip. op. at 4 (emphasis added).

after this Court's announcement of *Davis*, there are no equities which would justify the retention of these taxes.

The Supreme Court of Virginia's analysis of the equities also manifests a lack of understanding of the uniqueness of the personal income tax refund right. Most states have long since adopted the federal standard of equity and conscience which favors the taxpayer.[12] This standard has its genesis in several of this Court's decisions involving federal taxation. As noted in *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373 (1933), "[a] high-minded government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *Id.* at 379. This standard expressly rejects such "ignoble" concepts as payment under protest, the power of the sovereign to retain invalid exactions, and the power to qualify the refund right by prospective decisions. Moreover, the federal refund right is conditioned or limited *solely* by the statute of limitations. In *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947), this Court said:

> [W]e read the word 'overpayment' in its usual sense, as meaning any payment in excess of that which is properly due. Such an excess payment may be traced to an error in mathematics or in judgment or in interpretation of facts or law. And the error may be committed by the taxpayer or by the revenue agents. Whatever the reason, the payment of more than is rightfully due is what characterizes an overpayment.

[12] *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (banc), *cert. denied*, 493 U.S. 1019 (1990); New York Tax Law §§ 607(a), 687(a) (McKinney's 1986 & Supp. 1990) (App. D at 10a). *See also Kuhn v. State*, 817 P.2d 101 (Colo. 1991).

Id. at 531. This standard is based on sound considerations of public policy and seeks as its end to promote compliance with the income tax system.[13]

Indeed, Virginia's scheme of personal income taxation "piggybacks" on the federal scheme of taxation. Virginia has adopted the provisions of the Internal Revenue Code as the substantive state tax law, subject to limited statutory modifications. *See* Code §§ 58.1-301, 58.1-322 (App. F at 22a). In addition, the state refund right is not conditioned by a payment under protest provision and merely requires the timely filing of a refund claim. *See* Code §§ 58.1-1823, 58.1-1824; Reg. Sec. 630-2-499 D. (App. F at 22a). Virginia's scheme of personal income taxation expressly grants its citizens the right to claim and receive refunds of Virginia income taxes, which are attributable to intervening developments under the Internal Revenue Code. *Id.* Moreover, the period within which a refund may be claimed provides for an extended period of limitations where there is a change in the taxpayer's underlying federal income tax liability. *Id.*

Contrary to the decision below, the reliance interests of Virginia are meager. By virtue of its piggyback scheme of taxation, Virginia has expressly rendered its tax scheme subject to a host of unanticipated events, including unforeseen and unanticipated developments in the administrative rules of the Internal Revenue Service, enactments of Congress and federal decisional law. *See* Code § 58.1-301. Stated another way, the unforesen is an integral and anticipated element of the Virginia personal income tax law. Consequently, the contentions of the respondent below that the state refund right could be denied in this case because the refund liability was unforeseen is without merit.

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[13] *See* REPORT AND RECOMMENDATIONS ON TAXPAYER COMPLIANCE, American Bar Association Commission on Taxpayer Compliance, July, 1989, 41 Tax Lawyer 329, 353 (1988) ("Strict and unreasonable enforcement can, in fact, contribute to undermining the policy goals which the rules are designed to enforce.").

Moreover, the decision of the court below to qualify the petitioners' refund rights under state law raises an independent constitutional ground for invalidating the decision. Here, the petitioners, who are seeking to enforce a constitutional right, are being required to satisfy and defeat the condition of the prospectivity defense, a condition not otherwise imposed on other Virginia taxpayers.[14]

The petitioners' refund right cannot be subject to a defense based on the origin of the claim—the Constitution, when other Virginia income taxpayers' refund rights based on state law are not subject to or qualified by the defense. *See McKnett v. St. Louis & S.F. Ry.*, 292 U.S. 230, 234 (1934) ("A state may not discriminate against rights arising under federal laws.").

Refunds in cases such as this one would actually be in the best interest of the state because they would restore taxpayer confidence in the integrity and fairness of the personal income tax law of Virginia and the courts which are called upon to cure the abuses of those who are entrusted to enforce it. It is now a matter of common knowledge that honest citizens have less confidence in the fairness of the system and have been subject to widespread abuse by state tax collectors. This problem has become so significant that the organized bar has called for immediate reform by each of the states in light of its findings that:

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[14] For example, another taxpayer may challenge an item of federal adjusted gross income and by final judgment or settlement establish a new principle of law under the Internal Revenue Code. *See, e.g., Cottage Sav. Ass'n v. Commissioner*, 111 S. Ct. 1503 (1991). At the federal level, the taxpayer is entitled to a refund "whatever the reason." *Jones*, 332 U.S. at 531. That same taxpayer would then automatically be entitled to a refund of the Virginia tax attributable to that piggybacked item of income and, as a matter of Virginia law, could not be subject to the prospectivity defense, even if all the tests of the prospectivity defense were otherwise satisfied. *See* Reg. Sec. 630-2-499 D. Indeed, such a taxpayer would receive the benefit of an extended statute of limitations to make the claim. *Id.*

> For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Section of Taxation REPORT TO HOUSE OF DELEGATES, August, 1990 at 2. (App. E at 12a.) If Virginia is permitted to breach its obligation to its citizens to pay refunds, all citizens of Virginia will ultimately pay a higher price as the result of increasing noncompliance.

This Court should take the opportunity in this case to frame the scope of the inquiry necessary to sustain a finding of prospective application only. Indeed, if prospective decision making is ever permissible, at a minimum, it should require an affirmative showing of the taxing authority that under its settled practice in the context of the particular tax involved its conduct in denying a refund has been manifestly reasonable.

CONCLUSION

A state court simply does not have the power under the guise of the prospectivity doctrine to change the effective date of a congressional enactment. The decision below clearly conflicts with this settled principle of federalism. In view of the adverse impact that the decision below has already had on the decisions of other state courts and in view of the clarity of the decisional law regarding the obligations of courts to enforce unambiguous statutes according to their terms, *amici* respectfully urge that the Court grant the Petition and reverse the decision of the Supreme Court of Virginia. *See, e.g., Chase Manhattan Bank, N.A. v. Finance Admin.*, 440 U.S. 447 (1979).

Respectfully submitted,

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December 16, 1991

APPENDICES

APPENDIX A

PUBLIC SALARY TAX ACT OF 1939

AN ACT

Relating to the taxation of the compensation of public officers and employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Salary Tax Act of 1939".

TITLE I

SECTION 1. Section 22(a) of the Internal Revenue Code (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

SEC. 2. Section 116(b) of the Internal Revenue Code (exempting compensation of teachers in Alaska and Hawaii from income tax) is repealed.

SEC. 3. Section 22(a) of the Internal Revenue Code is amended by adding at the end thereof a new sentence to read as follows: "In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income".

SEC. 4. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession of political subdivision thereof, the District of Columbia, or any agency or

instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

TITLE II

SEC. 201. Any amount of income tax (including interest, additions-to-tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an assessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 19, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

SEC. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

SEC. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and

the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of such claim would result in the application of the doctrines in the cases of Helvering against Therrell (303 U.S. 218), Helvering against Gerhardt (304 U.S. 405), and Graves et al. against New York ex rel O'Keefe, decided March 27, 1939, extending the classes of officers and employees subject to Federal taxation.

SEC. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

SEC. 206. The terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code.

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treasury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

SEC. 209. In the case of the judges of the Supreme Court, and of the inferior courts of the United States created under article III of the Constitution, who took office on or before June 6, 1932, the compensation received as such shall not be subject to income tax under the Revenue Act of 1938 or any prior revenue Act.

SEC. 210. For the purposes of this Act, the term "officer or employee" includes a member of a legislative body and a judge or officer of a court.

SEC. 211. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Approved, April 12, 1939.

APPENDIX B

EXCERPTS FROM THE INTERNAL REVENUE CODE

[Sec. 111]

SEC. 111. RECOVERY OF TAX BENEFIT ITEMS.

[Sec. 111(a)]

(a) DEDUCTIONS.—Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.

[Sec. 164]

SEC. 164. TAXES.

[Sec. 164(a)]

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) The GST tax imposed on income distributions.

(5) The environmental tax imposed by section 59A.

In addition, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an activity described in section 212 (relating to expenses for

production of income). Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

APPENDIX C

EXCERPT FROM DoD ATLAS—FY 1989

DoD ESTIMATED PAYROLL AND PRIME CONTRACTS BY STATE

(THOUSANDS OF DOLLARS)
FISCAL YEAR 1989

State	Civilian Pay	Military Active Duty Pay	Reserve & National Guard Pay	Retired Military Pay	Total Compensation	Civil Functions Contracts	Military Functions Contracts	Total Contracts
Alabama	789,524	588,907	222,248	498,323	2,099,002	86,857	1,305,531	1,392,388
Alaska	193,392	567,974	24,774	64,562	850,702	17,458	522,337	539,795
Arizona	304,621	589,779	71,806	527,678	1,493,684	11,368	2,835,519	2,846,887
Arkansas	136,907	199,024	71,951	255,818	663,700	38,261	331,331	369,592
California	4,012,634	6,516,801	431,083	2,952,123	13,912,641	60,595	23,064,102	23,124,697
Colorado	363,176	1,008,837	114,248	563,590	2,039,851	6,899	2,921,402	2,928,301
Connecticut	146,690	287,806	49,112	135,908	637,516	1,269	6,081,021	6,082,290
Delaware	47,157	96,153	27,281	64,451	235,042	12,283	158,753	171,036
District of Columbia	564,469	386,633	98,044	66,730	1,115,876	6,652	1,229,312	1,235,964
Florida	1,030,474	2,215,970	153,749	2,092,292	5,492,485	28,356	4,424,027	4,452,383
Georgia	1,030,707	1,731,308	271,133	740,461	3,773,609	34,357	1,829,823	1,864,180
Hawaii	639,481	1,362,357	40,274	191,892	2,234,004	8,018	570,715	578,733
Idaho	34,934	112,486	39,122	98,955	285,497	667	74,122	74,789
Illinois	560,533	729,495	166,545	308,140	1,764,713	30,814	1,218,287	1,249,101
Indiana	456,254	141,030	184,216	185,580	966,580	9,714	1,753,363	1,763,077
Iowa	37,837	9,297	57,692	81,894	186,720	7,897	418,013	452,910
Kansas	180,175	623,131	188,094	192,962	1,162,362	6,754	948,213	954,967
Kentucky	350,445	1,093,166	102,836	210,812	1,757,259	23,573	309,151	332,724
Louisiana	237,848	686,722	111,654	307,564	1,343,788	221,848	1,471,639	1,693,487
Maine	307,916	182,335	31,304	118,118	639,673	385	369,626	370,011
Maryland	1,378,780	898,527	142,181	537,183	2,956,671	26,381	3,844,497	3,870,878
Massachusetts	367,011	283,266	145,629	244,936	1,040,842	13,459	8,744,008	8,757,467
Michigan	367,889	188,637	114,947	213,904	885,377	10,215	1,255,716	1,265,931
Minnesota	87,736	21,762	94,021	126,551	330,070	12,787	1,761,187	1,773,974
Mississippi	312,429	379,785	89,776	234,067	1,016,057	73,868	1,160,690	1,234,558
Missouri	630,224	422,642	187,227	317,805	1,557,989	42,655	6,239,994	6,282,549
Montana	37,566	93,064	26,769	59,910	217,309	2,461	78,075	80,536
Nebraska	113,564	343,581	37,941	125,349	620,435	4,663	217,021	221,684
Nevada	54,035	226,732	19,641	226,554	526,962	36	230,112	230,148
New Hampshire	45,718	99,595	21,008	114,726	281,047	6,722	471,076	477,798
New Jersey	711,011	493,703	145,965	279,003	1,629,682	108,900	3,284,471	3,393,371
New Mexico	290,290	349,384	49,515	261,623	950,812	9,356	615,676	625,032
New York	543,499	749,795	229,372	361,520	1,884,187	5,377	6,546,787	6,552,164
North Carolina	414,439	2,258,954	116,264	671,972	3,461,629	2,414	1,101,328	1,103,742
North Dakota	51,171	224,602	25,501	26,402	327,676	1,299	120,515	121,814
Ohio	1,091,153	342,997	150,893	369,835	1,954,878	15,955	5,053,413	5,069,358
Oklahoma	651,866	696,112	120,537	337,319	1,815,834	17,706	641,409	659,115
Oregon	98,312	22,374	54,359	221,917	386,962	7,013	171,513	178,526
Pennsylvania	1,474,544	224,904	306,218	457,779	2,463,445	63,893	2,764,139	2,828,032
Rhode Island	138,917	147,628	32,271	76,878	395,694	1,130	415,354	417,484
South Carolina	595,656	1,316,068	168,103	526,418	2,606,245	22,585	545,581	568,166
South Dakota	36,369	145,977	23,540	40,741	246,627	1,759	65,667	67,426
Tennessee	190,774	201,973	108,973	397,090	898,374	30,197	1,088,248	1,118,445
Texas	1,849,868	3,258,588	319,561	2,036,072	7,264,089	126,464	9,136,350	9,262,814
Utah	632,384	135,528	98,639	108,005	974,556	13,846	958,799	982,645
Vermont	17,544	1,992	23,798	33,297	76,631	764	162,595	163,359
Virginia	3,479,351	4,154,703	184,847	1,560,075	9,378,976	37,773	5,858,975	5,896,749
Washington	879,416	1,293,047	131,083	725,181	3,028,727	46,395	2,904,660	2,951,055
West Virginia	48,764	9,694	33,283	88,868	180,605	37,775	125,665	163,440
Wisconsin	94,037	23,889	171,867	125,980	415,773	7,361	1,073,428	1,080,789
Wyoming	32,276	81,796	13,199	36,624	163,895	123	67,013	67,136
Total U.S.	27,959,767	38,220,511	5,821,458	20,590,933	92,592,669	1,365,357	118,551,260	119,916,607

Prepared by: Washington Headquarters Services Directorate for Information Operations and Reports

APPENDIX D

EXCERPTS FROM NEW YORK TAX LAW

§ 607. Meaning of terms

(a) General. Any term used in this article shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required but such meaning shall be subject to the exceptions or modifications prescribed in this article or by statute. Any reference in this article to the laws of the United States shall mean the provisions of the internal revenue code of nineteen hundred eighty-six [1] (unless a reference to the internal revenue code of nineteen hundred fifty-four is clearly intended), and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time for the taxable year.

§ 687. Limitations on credit or refund

(a) General.—Claim for credit or refund of an overpayment of income tax shall be filed by the taxpayer within three years from the time the return was filed or two years from the time the tax was paid, whichever of such periods expires the later, or if no return was filed, within two years from the time the tax was paid. If the claim is filed within the three year period, the amount of the credit or refund shall not exceed the portion of the tax paid within the three years immediately preceding the filing of the claim plus the period of any extension of time for filing the return unless such claim is for a credit or a portion thereof pursuant to subsection (e) of section six hundred six of this chapter. If the claim is not filed within the three year period, but is filed within the two year period, the amount of the credit or refund shall not exceed the portion of the tax paid during the two years

immediately preceding the filing of the claim unless such claim is for a credit or a portion thereof provided pursuant to subsection (e) of section six hundred six of this chapter. Except as otherwise provided in this section, if no claim is filed, the amount of a credit or refund shall not exceed the amount which would be allowable if a claim had ben filed on the date the credit or refund is allowed.

APPENDIX E

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

REPORT TO HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association recommends to the state legislatures and municipal governing bodies of the United States that they adopt standards for state and local tax procedures that call for: (1) identical statutes of limitations for deficiencies and refunds; (2) identical interest rates for deficiencies and refunds; (3) no automatic imposition of penalties; (4) payment of disputed taxes only after the taxpayer is provided a hearing; (5) no seizure of property until after final adjudication; (6) a period of at least ninety days between the date of the deficiency notice and the date a notice of appeal is due; (7) the elimination of state fees to cover audit expenses; (8) providing taxpayers with due process; and (9) eliminating the need for taxpayers to relitigate identical legal issues in the same jurisdiction.

REPORT

For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Recent years have witnessed a significant increase in the amount of taxes raised at the state and local levels. For example, for the twelve months ended March 1989, state and local governments collected $488.1 billion—a 6.3 percent increase over the twelve month period that ended

March 1988. Increased tax revenues have resulted from tax increases (*e.g.*, rate increases, new taxes, broadening of existing tax bases) and enhanced enforcement of existing tax laws. The enhanced enforcement of state and local tax laws has increased the number of sensitive contacts between taxpayers and revenue collection agencies. The increase in contacts has heightened taxpayers' awareness of tax collection procedures. All of this has focussed discussion on the need for state tax policy makers and legislatures to give serious consideration to the procedural rights of taxpayers.

Consideration has led to very different responses. Some states have adopted procedural reforms through legislation while some states have done so through policy pronouncements from the revenue agency within the executive branch that is charged with implementing the tax laws. Further, some states have created a taxpayer advocate office, similar to the consumer advocate offices created during the 1960s and 1970s. Other differences are the ability to record interviews with auditors and the ability to sue the states. A comparison of all the laws that have passed is beyond the scope of this Report.

In September of 1988, California became the first state to adopt a taxpayers' bill of rights. California's legislation preceded the federal taxpayers' bill of rights. Subsequent to California's adoption, Arkansas, Illinois, Indiana, Kansas, Ohio, Oregon, and South Carolina also adopted taxpayer's bill of rights through legislation. Hawaii, Maryland, New York (state and city) and Texas adopted procedural reforms through policy pronouncements.

Over the years model legislation has been recommended that addressed procedural, due process and policy considerations in the state and local tax area. In addition to these model acts endorsed by the ABA, it is appropriate to enumerate broad principles to guide state tax policy makers and legislatures.

A review of the procedural reforms adopted by thirteen states reveals that none of the thirteen states have adopted all of the principles recommended.

Specific statutory language is not recommended because it is viewed that: (i) it is almost impossible to draft language to amend or replace existing language that is in many instances scattered throughout the statutory framework of the various states; (ii) some states have already enacted certain of the recommended principles into their statutes and would find statutory language covering additional principles difficult to use; (iii) informal discussions with officials from various states and with national tax organizations reveal that they do not think that statutory language would be desirable in this circumstance; and, (iv) it would be desirable to affect the procedural tax reform process that is currently sweeping the states in a timely fashion.

PRINCIPLES

1. *Statutes of Limitations—Other than Fraud*

   State and local statutes of limitations for assessments, in cases other than those involving fraud, should be the same for deficiency assessments and refunds.

   Federal audit adjustments should open state and local income tax periods which are otherwise closed by statute only for those issues raised in the federal audit.

2. *Interest Rates*

   Interest rates for deficiencies and refunds should be the same. Interest is payment for the time value of money. It should not be imposed at a rate that punishes a taxpayer for failure to pay taxes timely. State and local efforts to encourage timely payment of taxes and to punish non-compliance should be addressed by penalties and/or civil or criminal sanctions.

3. *Penalties*

   There should be no automatic imposition of penalties. Reasons for proposed penalties should be provided to the taxpayer by the taxing agency. The taxpayer should be given an opportunity to appeal, and penalties should be abated upon a showing by the taxpayer of reasonable cause. Penalties should not be enacted by legislatures to raise revenue—they should be designed solely to encourage compliance.

4. *Payment After Hearing*

   Taxpayers should not be required to post a bond or make a payment of a disputed tax until they have been afforded an opportunity for a hearing.

5. *Seizure of Property*

   A state or municipality should only be able to seize a taxpayer's property or levy against a taxpayer's assets after a final adjudication of the disputed amount or as a result of a jeopardy assessment where the probability of payment would be substantially reduced by the passage of time.

6. *Appeal Period*

   Taxpayers should not have to file a notice of appeal until at least ninety days have passed from the date on the notice of assessment. A reasonable period thereafter should be allowed for adequate preparation before a hearing is held and an opportunity should exist for the taxpayer to amend an appeal.

7. *Fees*

   Taxpayers should not have to pay the state or local government a fee for its expenses in auditing the taxpayers. Taxpayers should not have to pay the state or local government's court costs or litigation fees if a taxpayer prevails in a dispute.

8. *Due Process*

Taxpayers should be afforded both an opportunity for a hearing before an independent tribunal and receive an appealable decision therefrom. Taxpayers should also have the opportunity to be represented by counsel and afforded other standards of due process like the use of discovery.

9. *Application of Decisions*

Once the highest court in a jurisdiction rules on a particular legal issue taxpayers should not have to relitigate the identical issue in the same jurisdiction.

COMMENTS ON PRINCIPLES

1. *Statutes of Limitation—Other than Fraud*

The underlying premise supporting civil statutes of limitation is that there is a period beyond which establishing the factual characteristics of a case becomes burdensome, difficult or impractical. This is, likewise, true with regard to issues arising under state and local tax laws.

Several states have statutes of limitation that allow the state and local government a longer period to assess a tax deficiency than the taxpayer has to claim a refund. This is perceived as creating an inequity, particularly when the taxpayer has not committed fraud.

In the area of taxation, the facts needed to establish the taxpayer's correct liability are generally reflected in the taxpayer's books and records. In many instances, taxpayers maintain books and records solely for the purposes of being able to substantiate prior tax positions. Determining the period of time during which taxpayers should be required to maintain books and records is a subjective matter best left to the judgment of the legislature. However, once a tax-

payer has been asked to maintain books and records and to continue being exposed to potential increases related to past tax periods, it seems only fair to require that the government also expose itself to the risk of having to refund taxes erroneously paid for a like period.

Because many states and local jurisdictions use federal taxable income or federal adjusted gross income as a starting point in determining state income or franchise taxes, a federal audit adjustment may trigger the need to file an amended state or local income tax return. Often, the federal audit adjustment is made after the statute of limitation has expired for auditing the state or local income tax return. When this occurs, the federal audit adjustment should not be used by the state or local government as an excuse to audit the taxpayer's state or local income tax return for issues other than those raised in a federal audit.

2. *Interest Rates*

Consistent with the treatment of interest applied to federal income tax deficiencies and refunds, some states and local governments apply a higher interest rate to deficiencies than they pay when taxes are refunded.

This appears to be an unjustifiable position if one accepts the premise that interest should be the payment for the time value of money. Interest should not be used to punish a taxpayer for the over- or underpayment of taxes—this is best done through penalties and other civil/criminal sanctions.

Some commentators have advanced the argument that higher interest rates are justified for deficiencies than for refunds because the state takes a credit risk with respect to the taxpayer's ability to pay the deficiency

whereas the taxpayer presumably bears a smaller risk. Some taxpayers, however, are excellent credit risks, on apar with governmental bodies. It is inequitable to apply a higher interest rate to all taxpayers with deficiencies because a few are poor credit risks. If there is a question about a taxpayer's ability to pay a deficiency, seizure of property remedies are available. See comment on seizure of property, below.

3. *Penalties*

In recent years, the imposition of penalties has begun to be used as a revenue raising technique. Many tax jurisdictions automatically add penalty assessments to virtually all tax deficiencies. This is inappropriate if a taxpayer is neither notified of the reasons for the proposed penalties nor provided an opportunity to appeal such penalties. At a minimum, the tax agency should be required to have some basis for the penalty imposition. Further, penalties should be abated upon a showing of a reasonable cause.

4. *Payment After Hearing*

In many instances, taxpayers are required to post a bond or make payment of disputed taxes before being afforded an opportunity for an administrative appeal. This is inconsistent with federal income tax procedure and may often impose a severe hardship on taxpayers, especially when taxes erroneously collected from taxpayers are later refunded at below market interest rates.

5. *Seizure of Property*

Many state and local tax authorities abuse their power to seize property by exercising this power much too frequently. This power should be utilized only after a final adjudication of the disputed amount or in instances where a designated governmental official de-

termines that the probability of payment (*i.e.*, the collection for a deficiency) would be substantially reduced by the passage of time. The standards utilized to determine whether a jeopardy assessment is appropriate should be similar to those adopted by the federal government for purposes of the collection of federal taxes. Treasury Regulation 1.6851-1(1) (a) sets forth three conditions where a collection is in jeopardy; (i) the taxpayer is or appears to be "designing quickly" to leave the United States or go into hiding; (ii) the taxpayer is or appears to be "designing quickly" to place taxpayer's assets outside the reach of the government by removing, concealing, dissipating or transferring the assets; or, (iii) the taxpayer's financial solvency is or appears to be imperiled.

6. *Appeal Period*

A taxpayer's ability to appeal a tax assessment is basic to providing the taxpayer with due process. The regular delays encountered with mailing assessment notices and the amount of time necessary to evaluate such notices and determining whether an appeal is appropriate require that taxpayers be provided at least ninety days from the date on the assessment notice to file a notice of appeal. Shorter appeal periods often effectively eliminate any opportunity for due process.

As a related matter, once a notice of appeal is filed, taxpayers should be given time to amend such notice in order to perfect the appeal. Otherwise, a requirement that the taxpayer set forth his entire case may in some instances deprive taxpayers of the opportunity to analyze thoroughly the notice of assessment in conjunction with the taxpayer's books and records and other relevant information.

7. *Fees*

Some jurisdictions impose fees on taxpayers for expenses incurred in auditing the taxpayer and for legal costs incurred in defending tax appeals. While user fees may be an appropriate way of funding government services, it is unreasonable to charge taxpayers for the state's audit costs and it is also unreasonable to charge court costs if the taxpayer prevails in a dispute.

8. *Due Process*

Minimum standards of due process should be afforded a taxpayer when a tax is in dispute. Those standards include: (i) the opportunity to appeal an assessment before an independent tribunal; (ii) the opportunity to receive a decision from the independent tribunal which decision can then be appealed to a court; (iii) representation by counsel; (iv) the ability to call witnesses including government witnesses; and, (v) the availability of discovery to all parties.

It is believed that if the first level administrative appeal is provided by a part of an agency that has revenue collection responsibilities, then a de novo appeal should be provided to the taxpayer. In at least one jurisdiction (New York State) the revenue collection agency (*i.e.*, the Department of Taxation and Finance) cannot appeal unfavorable decisions from the Tax Appeals Tribunal to the courts. The concern is that this may have a chilling effect on the willingness of the tax tribunal to rule in favor of the taxpayer on the theory that the taxpayer can always appeal to the courts.

The burden of proof should generally be on the taxpayer, but, irrespective of who bears the burden of proof, the burden should ordinarily be met by a preponderance of the evidence.

9. *Application of Decisions*

State and local governments should establish procedures for implementing judicial resolutions of legal issues. Once the tax authority has lost a legal issue against a taxpayer, before the highest court in the state, there should exist some mechanism for ensuring that similarly situated taxpayers will not be faced with the litigation of legal issues that have already been resolved.

10. *Prospectivity*

There is a strong reluctance on the part of state and local governments to grant tax refunds when a tax has been held to be illegal or unconstitutional. Sometimes, there is a reluctance to refund taxes to the taxpayer litigant, and other times there is a reluctance to refund taxes to all similarly situated taxpayers unless those taxpayers have filed protective refund claims and/or lawsuits. The reluctance to grant refunds provides taxpayers with a disincentive to contest taxes and may serve to erode confidence in a voluntary system of tax compliance.

The issue of whether federal law requires state and local governments to provide taxpayers with retroactive relief when taxes have been exacted in violation of the commerce clause is before the U.S. Supreme Court in th case of *McKesson Corporation v. State of Florida* (October 1989 Term). While the tax authorities' reluctance to part with taxes that have been spent is understandable, the government's should either be prepared to refund taxes or they should escrow disputed taxes. However, no position is being taken on this issue, at this time, pending a review of the forthcoming Supreme Court decision.

Respectfully submitted,

JAMES P. HOLDEN
August, 1990

APPENDIX F

EXCERPTS FROM THE VIRGINIA INCOME TAX LAW AND REGULATIONS

Sec. 58.1-301. Conformity of terms to Internal Revenue Code.—A. Any term used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.

B. Any reference in this chapter to the laws of the United States relating to federal income taxes shall mean the provisions of the Internal Revenue Code of 1954, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time.

Sec. 58.1-322. Virginia taxable income of residents.—A. The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, which excludes combat pay for certain members of the Armed Forces of the United States as provided in § 112 of the Internal Revenue Code, as amended, and with the modifications specified in this section.

Sec. 58.1-1823. Reassessment and refund upon filing of amended return.—A. Any person filing a tax return required for any tax administered by the Department of Taxation may, within three years from the last day prescribed by law for the timely filing of the return, or within sixty days from the final determination of any change or correction in the liability of the taxpayer for any federal tax upon which the state tax is based, whichever is later, file an amended return with the Department. If the Department is satisfied, by evidence submitted to it or otherwise, that the tax assessed and paid upon the original return exceeds the proper amount, the Department may reassess the taxpayer and order that any

amount excessively paid be refunded to him. The Department may reduce such refund by the amount of any taxes penalties and interest which are due for the period covered by the amended return, or any past-due taxes, penalties and interest which have been assessed within the appropriate period of limitations. Any order of the Department denying such reassessment and refund, or the failure of the Department to act thereon within three months shall, as to matters first raised by the amended return, be deemed as assessment for the purpose of enabling the taxpayer to pursue the remedies allowed under this chapter.

Sec. 58.1-1824. Protective claim for refund.—Any person who has paid an assessment of taxes administered by the Department of Taxation may preserve his judicial remedies by filing a claim for refund with the Tax Commissioner on forms prescribed by the Department within three years of the date such tax was assessed. Such taxpayer may, at any time before the end of one year after the date of the Tax Commissioner's decision on such claim, seek redress from the circuit court under § 58.1-1825. The Tax Commissioner may decide such claim on the merits in the manner provided in § 58.1-1822 for appeals under § 58.1-1821, or may, in his discretion, hold such claim without decision pending the conclusion of litigation affecting such claim. The fact that such claim is pending shall not be a bar to any other action under this chapter.

Reg. Sec. 630-2-499. Individual refunds; crediting overpayment against estimated tax.

• • • •

D. Statute of Limitations. No refund of any overpayment shall be made except upon discovery by the department or written application of the taxpayer within three years of the due date of the return for such taxable year or within sixty days from the final determination of any change or correction in the taxpayer's liability for federal income tax, whichever is later.

Supreme Court, U.S.
FILED
JUL 2 1992
OFFICE OF THE CLERK

No. 91-794

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

On Writ of Certiorari to the Supreme Court of Virginia

JOINT APPENDIX

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PETITION FOR CERTIORARI FILED NOVEMBER 15, 1991
CERTIORARI GRANTED MAY 18, 1992

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COMMONWEALTH OF VIRGINIA

IN THE CIRCUIT COURT
OF THE CITY OF ALEXANDRIA

CL891080

HENRY HARPER, *et al.*

vs.

COMMONWEALTH OF VIRGINIA

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
December 7, 1989	Transfer from Richmond Circuit Court
May 31, 1989	Complaint
June 22, 1989	Motion for Leave to Amend Complaint
June 23, 1989	Order
June 30, 1989	Complaint
July 21, 1989	Answer and Grounds of Defense
October 31, 1989	Plaintiff's Motion for Partial Summary Judgment
October 31, 1989	Declaration of Henry Harper
October 30, 1989	Order
November 17, 1989	Receipt of Transfer and Request for Filing Fee
February 12, 1990	Letter Opinion
	Order: defendant's motion for summary judgment granted and plaintiffs' motion for partial summary judgment denied.

DATE	PROCEEDINGS
March 15, 1990	Notice of Appeal
April 30, 1990	Notice of Filing Transcript
September 11, 1990	Order from Supreme Court: appeal awarded. Appeal bond to be posted.
October 15, 1990	Cost Bond
March 22, 1991	Order from Supreme Court: judgment is affirmed.
March 22, 1991	Opinion by Justice Roscoe B. Stephenson, Jr.
April 26, 1990	TRANSCRIPT OF FEBRUARY 2, 1990 PLAINTIFFS EXHIBIT—NONE DEFENDANTS EXHIBIT—NONE

VIRGINIA:

IN THE SUPREME COURT OF VIRGINIA

Record No. 900770

HENRY HARPER, *et al.*,
Appellants,
against

VIRGINIA DEPARTMENT OF TAXATION,
Appellee.

RELEVANT DOCKET ENTRIES

DATE	PROCEEDINGS
June 11, 1990	Petition for appeal
June 13, 1990	Record from trial court Manuscripts (5 vols.) Transcript (1 vol.) No exhibits No depositions
July 2, 1990	Brief in opposition
September 7, 1990	Order entered
October 17, 1990	Joint appendix (1 vol.)
October 17, 1990	Brief for appellants (1 vol.)
November 9, 1991	Letter from Clerk's Office to counsel
November 13, 1990	Brief of appellee (1 vol.)
November 27, 1990	Appellants' reply brief (1 vol.)
December 6, 1990	Order entered
March 1, 1991	Opinion rendered

DATE	PROCEEDINGS
March 1, 1991	Order entered
July 1, 1991	Letter from the Supreme Court of the United States to the Clerk's Office, dated June 28, 1991
July 9, 1991	Order entered
August 1, 1991	Letter, with attachments, from Supreme Court of the United States to Clerk's Office, dated July 30, 1991
August 1, 1991	Order entered
August 27, 1991	Appellee's brief on remand (1 vol.)
September 6, 1991	Appellants' reply brief on remand (1 vol.)
November 8, 1991	Opinion rendered
November 8, 1991	Order entered
May 21, 1992	Letter with attachment from the Supreme Court of the United States to Clerk's Office, dated May 18, 1992 Order entered
May 21, 1992	Order entered on
June 1, 1992	Letter from Supreme Court of the United States to Clerk's Office, dated May 28, 1992

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

COMPLAINT

Plaintiff Virginia taxpayers bring this action to obtain refunds of the income taxes they have overpaid during the tax years 1985, 1986, 1987 and 1988, as these taxes were assessed and collected from them in violation of the Constitution and laws of the United States.

PARTIES

1. Plaintiff Henry Harper is a citizen of the United States, a resident of the Commonwealth of Virginia and President of the Virginia Federation of Chapters of the National Association of Retired Federal Employees. He has paid income tax for the years 1985 through 1988 to the Commonwealth of Virginia on his income, including that portion of his income representing his federal civil service annuity for past service to the federal government. He has submitted an amended return for these tax years, representing his income to exclude that portion attributable to his civil service annuity.

2. Plaintiff H.T. Steve Morrissey is a citizen of the United States, a resident of the Commonwealth of Virginia and President of the National Association of Retired Federal Employees. He has paid income tax for the years 1987 and 1988 to the Commonwealth of Virginia on his income, including that portion of his income representing his federal civil service annuity for past service to the federal government. He has submitted an amended return for these tax years, representing his in-

come to exclude that portion attributable to his civil service annuity.

3. Plaintiffs Oscar J. Honeycutt, Rose S. Musumeci, Nancy B. Walsh, Mrs. Gay H. Packett, Ernest F. Kerekes, Yuell Chandler, Ransom L. Porter, Alan T. Spiher, Jr., Robert P. Halpin, Harold E. Krueger, Donald W. MacCloskey, Donald P. Dollens, Nelson Freeney and Robert K. Reynolds, are citizens of the United States of America residents of the Commonwealth of Virginia and elected board members of the Virginia Federation of Chapters of the National Association of Retired Federal Employees. They have paid income tax during the years 1985 through 1988 to the Commonwealth of Virginia on their income, including that portion of their income representing their federal civil service annuity. They have submitted amended returns for these tax years, representing their income to exclude that portion attributable to their civil service annuity.

4. Remaining named plaintiffs also are citizens of the United States, residents of the Commonwealth of Virginia and members of the National Association of Retired Federal Employees and various chapters of the Virginia Federation of Chapters of the National Association of Retired Federal Employees. They have paid income tax during the years 1985 through 1988 to the Commonwealth of Virginia on their income, including that portion of their income representing their federal civil service annuity. They have submitted amended returns for these tax years, representing their income to exclude that portion attributable to their civil service annuity.

5. Defendant Virginia Department of Taxation is the agency authorized by law in the Commonwealth of Virginia to administer, collect and refund all taxes paid on personal income by Virginia citizens.

JURISDICTION

6. Jurisdiction is based upon Section 58.1-1825 of the Code of Virginia. Defendant has not allowed any of plaintiffs' amended returns and has announced that no refunds for the unconstitutionally collected taxes will be paid. In recognition of defendant's refusal to pay any such refunds unless ordered to do so by a court of competent jurisdiction, the General Assembly has enacted a provision postponing the deadline by which affected taxpayers may file for refunds until one year after final judicial resolution of the question of whether refunds must be paid.

7. Venue is proper under subdivision 13b(4) of Section 8.01-261 of the Code of Virginia.

STATEMENT OF THE FACTS

8. At all times relevant hereto, the Commonwealth of Virginia imposed a tax on the income of the residents of Virginia. Included within the definition of income for purposes of this tax were any and all amounts received by individuals from the United States Government as pension benefit payments. Specifically excluded from income, were amounts received by individuals from the Commonwealth of Virginia, its subdivisions and agencies as pension or retirement benefit payments because of their service as employees, or because of their status as surviving spouses of employees, of the Commonwealth of Virginia, its subdivisions, and agencies. See Code of Virginia, Section 58.1-322(C)(3). This discriminatory treatment of federal retirees violates 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine of the Supremacy Clause of the United States Constitution.

STATEMENT OF CLAIMS

9. Paragraphs 1 through 8 are realleged and incorporated by reference.

10. Virginia's exclusion of state and local annuities from income taxation, while fully taxing federal annui-

ties, violates 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine of the Supremacy Clause of the United States Constitution. Taxes collected under this unlawful scheme are excessive within the meaning of Article 58.1-1823 of the Code of Virginia.

11. The Commonwealth of Virginia has provided by statute that individuals who have paid excessive taxes may, upon the filing of an amended return, obtain a refund. See Code of Virginia, Sections 58.1-1823-1825. The purpose of this provision is to provide an expeditious remedy for relief against taxes that have been erroneously, illegally, or unconstitutionally collected.

12. During the tax years since 1985, plaintiffs have paid excessive taxes which have been unconstitutionally and illegally exacted taxes.

WHEREFORE, plaintiffs demand the following relief:

a. That this Court declare that plaintiffs are entitled, and defendant must pay, refunds for all unconstitutionally assessed and collected taxes they have paid since 1985.

b. That judgment be entered by this Court against the defendant, Virginia Department of Taxation, for the total amount of refund due the plaintiffs for all unconstitutionally assessed and collected taxes that each plaintiff has paid since 1985.

c. That this Court order defendant to pay such refunds to plaintiffs.

d. That this Court provide such other and further relief as the Court deems just and proper.

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IN THE CIRCUIT COURT OF
THE CITY OF ALEXANDRIA, VIRGINIA

Law Action No. CL890462

JOHN BERNARD MORRIS and FRANCES PRIDDY MORRIS
4318 Louis Place, Alexandria, Virginia 22304,
Plaintiffs,

v.

THE VIRGINIA DEPARTMENT OF TAXATION,
Defendant.

AMENDED COMPLAINT

Plaintiffs JOHN BERNARD MORRIS and FRANCES PRIDDY MORRIS, through their attorneys, bring this action to obtain refunds against the Defendant, The Virginia Department of Taxation.

PARTIES

1. Plaintiffs JOHN BERNARD MORRIS and FRANCES PRIDDY MORRIS are citizens of the Commonwealth of Virginia and reside at 4318 Louis Place, Alexandria, Virginia, and have filed income tax returns with the Commonwealth of Virginia at least during the years 1977 through 1988, inclusive.

2. Plaintiff JOHN BERNARD MORRIS currently receives pension benefit payments from the United States Government pursuant to the civil service laws of the United States as a result of his extended service as an employee with agencies of the United States Government.

3. Defendant Virginia Department of Taxation is the Agency authorized by law in the Commonwealth of Virginia to administer, collect and refund all taxes paid on personal income by Virginia citizens.

4. WILLIAM FORST is the duly appointed Tax Commissioner of the Commonwealth of Virginia, and, as such, has the overall responsibility for the administration of the Virginia Department of Taxation.

JURISDICTION

5. Jurisdiction is based upon Section 58.1-1825 of the Code of Virginia. Plaintiffs have paid Virginia state income taxes invalidly, erroneously, and unconstitutionally assessed against them for the taxable years 1977 through 1988. Plaintiffs have filed a claim for refund for invalidly collected and assessed taxes for the taxable year 1985.

6. Venue is proper under subdivision 13 b of Section 8.01-261 of the Code of Virginia.

STATEMENT OF FACTS

7. At all times relevant hereto, the Commonwealth of Virginia has imposed a tax on the income of the residents of Virginia. At all times relevant hereto, the Commonwealth of Virginia has required that the calculation of taxable income for the purpose of imposing the state income tax include any and all amounts received by individuals from the United States Government as pension benefit payments. However, at all times relevant hereto, the Commonwealth of Virginia has, by statute, specifically exempted from the calculation of taxable income amounts received by individuals from the Commonwealth of Virginia as pension or retirement benefit payments because of their service as employees, or because of their status as surviving spouses of employees, of the Commonwealth of Virginia, its subdivisions, and agencies. See Code of Virginia, Title 58.1-322(C)(3).

8. At all times relevant hereto and at least during 1977 through 1988 inclusive, plaintiffs have been required to include and plaintiffs have in fact included in their calculation of taxable income reported to the Commonwealth of Virginia all amounts received by them as pension benefit payments from the United States Government as a result of his employment as civil servants. Plaintiffs have paid Virginia State income tax on all such amounts so included in the calculation of taxable income.

9. Plaintiff has filed amended return for the taxable year 1985 and has sought refund of all taxes paid during that year on income received from the United States Government in the form of pension benefit payments. To date, no action has been taken by the Virginia Department of Taxation with regard to this filing.

10. In April, 1989, Section 58.1-1823 of the Code of Virginia was amended to provide that a claim for refund "for any taxable year beginning on or after January 1, 1985, may be filed within one year from the entry of a final judicial order of a court of competent jurisdiction not subject to further appeal resolving the issue of the application to Virginia income tax law of the United States Supreme Court decision in the case of *Davis v. Michigan Department of the Treasury*, 57 U.S.L.W. 4389 (U.S. March 28, 1989)."

STATEMENT OF CLAIMS

11. Paragraphs 1 through 10 are realleged and incorporated by reference.

12. This Count is against Defendant for unconstitutionally discriminating against plaintiffs in violation of 4 U. S. C., Section 111.

13. The Commonwealth of Virginia has exempted from income taxation amounts received as pension and retirement benefits by retirees of the Commonwealth of Virginia, its subdivisions, and agencies, while refusing to

exempt from income taxation amounts received by retirees of the United States Government or the armed forces of the United States. Such taxation unlawfully, illegally, and unconstitutionally discriminates against federal government and military retirees "because of the source of the pay or compensation" within the meaning of 4 U.S.C., section 111.

WHEREFORE, plaintiffs demand the following relief:

a. This Court determine that Title 58.1-322 of the Code of Virginia is unlawful to the extent it discriminates between federal and state retirees.

b. That defendant be enjoined from enforcing or administering Title 58.1-322 of the Code of Virginia to the extent it unlawfully discriminates against federal retirees.

c. That plaintiffs be awarded the refunds and damages they have suffered as a result of the defendant's unlawful discrimination, including but not limited to, all amounts paid as state income tax on pension and retirement benefits received from the United States plus interest; and

d. That plaintiff be awarded the costs of this suit, including attorneys's fees and such other relief as the Court deems just and proper.

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(Certificate of Service Omitted in Printing)

IN THE CIRCUIT COURT OF
THE CITY OF ALEXANDRIA, VIRGINIA

Law Action No. CL890463

GEORGE J. RABIL and HELEN T. RABIL
5321 Truman Avenue
Alexandria, Virginia 22304,
Plaintiffs,

v.

THE VIRGINIA DEPARTMENT OF TAXATION,
Defendant.

AMENDED COMPLAINT

Plaintiffs GEORGE J. RABIL and HELEN T. RABIL, through their attorney, bring this action to obtain refunds against the Defendant, The Virginia Department of Taxation.

PARTIES

1. Plaintiff GEORGE J. RABIL and HELEN T. RABIL are citizens of the Commonwealth of Virginia and reside at 5321 Truman Avenue, Alexandria, Virginia, 22304, and have filed income tax returns with the Commonwealth of Virginia at least during the years 1985 through 1988, inclusive.

2. Plaintiff GEORGE J. RABIL currently receives pension benefit payments from the United States Government pursuant to the civil service laws of the United States as a result of his extended service as an employee with agencies of the United States Government. Plaintiff GEORGE J. RABIL also currently receives separate benefit payments from the United States as a result of his lengthy service on active duty and in the organized reserves in the United States Army. Plaintiff has received

such pension benefits from the United States at least since 1985.

3. Defendant Virginia Department of Taxation is the Agency authorized by law in the Commonwealth of Virginia to administer, collect and refund all taxes paid on personal income by Virginia citizens.

JURISDICTION

4. Jurisdiction is based upon Section 58.1-1825 of the Code of Virginia. Plaintiffs have paid Virginia state income taxes invalidly, erroneously, and unconstitutionally assessed against them for the taxable years 1985 through 1987. Plaintiffs have filed claims for refund for invalidly collected and assessed taxes for the taxable years 1985 through 1987. The Virginia Department of Taxation have denied those claims for refund.

5. Venue is proper under subdivision 13 b of Section 8.01.261 of the Code of Virginia.

STATEMENT OF FACTS

6. At all times relevant hereto, the Commonwealth of Virginia has imposed a tax on the income of the residents of Virginia. At all times relevant hereto, the Commonwealth of Virginia has required that the calculation of taxable income for the purpose of imposing the state income tax include any and all amounts received by individuals from the United States Government as pension benefit payments. However, at all times relevant hereto, the Commonwealth of Virginia has, by statute, specifically exempted from the calculation of taxable income amounts received by individuals from the Commonwealth of Virginia as pension or retirement benefit payments because of their service as employees, or because of their status as surviving spouses of employees, of the Commonwealth of Virginia, its subdivisions, and agencies. See Code of Virginia, Title 58.1-322(C)(3).

7. At all times relevant hereto and at least during 1980 through 1987 inclusive, plaintiffs have been required to include and plaintiffs have in fact included in their calculation of taxable income reported to the Commonwealth of Virginia all amounts received by them as pension benefit payments from the United States Government as a result of his employment as civil servants. Plaintiffs have paid Virginia State income tax on all such amounts so included in the calculation of taxable income.

8. Plaintiffs have filed amended returns for the taxable years 1985 through 1987 and have sought refund of all taxes paid during those years on income received from the United States Government in the form of pension benefit payments. To date, no refunds have been made to plaintiffs by the Virginia Department of Taxation with regard to these filings.

9. In April, 1989, Section 58.1-1833 of the Code of Virginia was amended to provide that a claim for refund "for any taxable year beginning on or after January 1, 1985, may be filed within one year from the entry of a final judicial order of a court of competent jurisdiction not subject to further appeal resolving the issue of the application to Virginia income tax law of the United States Supreme Court decision in the case of *Davis v. Michigan Department of the Treasury*, 57 U.S.L.W. 4389 (U. S. March 28, 1989)."

STATEMENT OF CLAIMS

10. Paragraphs 1 through 10 are realleged and incorporated by reference.

11. This Count is against Defendant for unconstitutionally discriminating against plaintiffs in violation of 4 U.S.C., Section 111.

12. The Commonwealth of Virginia has exempted from income taxation amounts received as pension and retirement benefits by retirees of the Commonwealth of

Virginia, its subdivisions, and agencies, while refusing to exempt from income taxation amounts received by retirees of the United States Government or the armed forces of the United States. Such taxation unlawfully, illegally, and unconstitutionally discriminates against federal government and military retirees "because of the source of the pay or compensation" within the meaning of 4 U.S.C., section 111.

WHEREFORE, plaintiffs demand the following relief:

a. This Court determine that Title 58.1-322 of the Code of Virginia is unlawful to the extent it discriminates between federal and state retirees.

b. That defendants be enjoined from enforcing or administering Title 58.1-322 of the Code of Virginia to the extent it unlawfully discriminates against federal retirees.

c. That plaintiffs be awarded the refunds and damages they have suffered as a result of the defendants' unlawful discrimination, including but not limited to, all amounts paid as state income tax on pension and retirement benefits received from the United States plus interest; and

d. That plaintiffs be awarded the costs of this suit, including attorneys' fees and such other relief as the Court deems just and proper.

//s George J. Rabil
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202-347-1843
Counsel for Plaintiffs

VIRGINIA:

IN THE CIRCUIT COURT
OF THE CITY OF VIRGINIA

Case No.: N-8135-1

RAYMOND S. WESTER, COL., USA Ret.,
JOHN C. CHAPMAN, COL., AUS, Ret.,
JACK MAYER, COL., USA, Ret.,

and

ALVIN T. MCCONNELL, COL., USA, Ret.,
Plaintiffs.

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant.

SECOND AMENDED COMPLAINT

[Filed Nov. 29, 1989]

Come now the plaintiffs, by counsel, and for their Amended Complaint state as follows:

1) The plaintiffs, bring this action to obtain refunds of the income taxes paid to the Commonwealth of Virginia during one or more of the years 1985, 1986, 1987 and 1988, inclusive, which income taxes were improperly, erroneously and illegally assessed and collected from the plaintiffs, in violation of the Constitution and Laws of the United States.

2) The plaintiffs, Raymond S. Webster, Col., USA (Ret.); John C. Chapman, Col. AUS (Ret.); Jack Mayer,

Col., USA (Ret.); and Alvin T. McConnell, Col., USA (Ret.) are all citizens of the United States and the Commonwealth of Virginia. Each of these plaintiffs is an officer and director of the Military Retirees Taxpayers Association of VA, Inc., an association of individuals who are recipients of retirement benefits from the United States government ("federal retirement benefits") who were assessed and have paid income tax to the Commonwealth of Virginia during one of more of the years 1985 through 1988, inclusive, upon the federal retirement benefits they received.

3) Each of the plaintiffs, assert and claim that the assessment of income tax by the Commonwealth of Virginia upon their federal retirement benefits for the years 1985 through 1988, inclusive, was improper, erroneous and illegal and in violation of the Constitution and Laws of the United States.

4) The defendant, Virginia Department of Taxation, is the agency authorized by law in the Commonwealth of Virginia to administer, collect and refund all taxes paid on personal income by Virginia citizens.

5) This action is being brought pursuant to § 58.1-1825 of the Code of Virginia.

6) At all times relevant hereto, the Commonwealth of Virginia imposed a tax on the income of the residents of Virginia. Included within the definition of income for purposes of this tax were any and all amounts received by individuals from the United States Government as pension benefit payments (referred to as "federal retirement benefits" herein). Specifically excluded from the definition of income, however, were amounts received by individuals from the Commonwealth of Virginia, its subdivisions and agencies, as pension or retirement benefit payments because of their service as employees, or because of their status as surviving spouses of employees, of the Commonwealth of Virginia, its subdivisions, and

agencies. Such exclusion was provided in § 58.1-322 (C) (3) of the Code of Virginia.

7) Virginia's exclusion of state and local pensions and retirement income from income taxation, while fully taxing federal retirement benefits, violates 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine of the Supremacy Clause of the United States Constitution. Taxes assessed and collected under this unlawful scheme are erroneous and otherwise improper within the meaning of § 58.1-1825 of the Code of Virginia.

8) During the tax years since 1985, plaintiffs have paid excessive taxes which have been unconstitutionally and illegally collected pursuant to erroneous and otherwise improper assessments. The plaintiffs are entitled, under the statutory refund provisions of the Code of Virginia, to full refunds of these unconstitutionally exacted taxes.

WHEREFORE, plaintiffs demand the following relief:

a. That this Court declare that plaintiffs are entitled to, and defendant must pay, refunds for all unconstitutionally assessed and collected taxes they have paid since 1985.

b. That judgment be entered by this Court against the defendant, Virginia Department of Taxation, for the total amount of refund due the plaintiffs and for all unconstitutionally assessed and collected taxes that each has paid since 1985.

c. That this Court order defendant to pay such refunds to plaintiffs.

d. That this Court provide such other and further relief as the Court deems just and proper.

RAYMOND S. WEBSTER, COL.,
USA, Ret., etc., *et als.*

By: /s/ Gregory S. Hooe,
Of Counsel

/s/ Mary-Leslie Duty
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Counsel

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(Certificate of Service Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

Nos. CL 891080
CL 890462
CL 890463
CL 891079
CL 891081

HENRY HARPER, *et als.*,
Plaintiffs,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Defendant;

and

ET ALS.

AFFIDAVIT OF W. H. FORST

W. H. Forst, being duly sworn, according to law, states as follows:

1. I am W. H. Forst, Tax Commissioner for the Commonwealth of Virginia. I was first appointed to that position in 1971 by then Governor Linwood Holton, and have been reappointed by each Governor since then, including most recently in 1986 by Governor Gerald L. Baliles.

2. As Tax Commissioner, I am responsible for the administration of the tax laws of the Commonwealth, including the issuance of ruling letters, promulgation of regulations, and determination letters upon taxpayers'

application for correction of tax assessments for any tax administered by the Virginia Department of Taxation.

3. Virginia Code § 58.1-322(C)(2) (repealed by Ch. 3, 1989 Va. Acts Special Session II at 2), which provided a subtraction from federal adjusted gross income for Virginia state and local government retirement benefits, had been a part of Virginia's individual income tax structure since March 31, 1942. *See* Ch. 325, 1942 Va. Acts at 500.

4. This Virginia subtraction enhanced Virginia's state and local government retirement benefits which were lower than federal retirement benefits.

5. The Department recognizes the applicability of the holding in *Davis* to Virginia and by legislative amendments enacted by a special session of the General Assembly in April of 1989, for taxable years beginning on or after January 1, 1989, federal and private retirement income will be treated identically to state and local retirement income. As to prior taxable years, the Department believes that it acted lawfully in taxing federal retirement income based upon the principle of nonretroactivity.

Signed by my hand this 18th day of December, 1989.

/s/ W. H. Forst
W. H. FORST

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF ROBERT T. BENTON, Ph.D.

ROBERT T. BENTON, being duly sworn, according to law, states as follows:

1. I am the Chief Economist and Director of the Research Division of the Virginia Department of Taxation, and have been employed in that capacity since 1976. I am responsible for directing and supervising this division's activities, which include forecasting and tracking general fund revenues for the Commonwealth's budget planning process, and developing revenue impacts of proposed tax legislation introduced into the General Assembly, and requested federal legislation with which Virginia is required to conform. The information contained in this affidavit was developed by me and members of my staff working under my direction and supervision.

2. One of my duties in calendar year 1989 was to determine for the Department an estimate of Virginia's potential refund liability for state individual income taxes paid by federal retirees on their federal pension income for taxable years 1985, 1986, 1987 and 1988. The estimated sum of potential tax refunds for these years amounts to $397.3 million. This amount includes estimated taxes paid on federal pension income which are estimated at $329.8 million plus interest of $67.5 million to December 31, 1989. We also calculate, assuming constant interest rates, that interest will continue to accrue on the refund amount at roughly $3.4 million per month.

3. The estimated potential refund claim of $397.3 million constitutes roughly 15.4 percent of all individual income tax revenues collected in calendar year 1987.

4. The total number of individual income tax returns processed for the 1987 taxable year was 2.56 million. Of that number, approximately 415,000 returns included retirement benefits (private, state, local and federal). The number of returns filed by persons receiving civil service or military retirement benefits was 134,000. Since approximately 43 percent of those were in the "married filing separately on a combined return" status where more than one taxpayer files on one return, the total number of persons receiving civil service or military retirement benefits who may be eligible for a refund could be as many as 192,000. In addition, based upon information the Department has received from the Virginia Supplemental Retirement System and the Virginia Municipal League, the number of persons receiving state and local government retirement benefits

(i) from the Virginia Supplemental Retirement System at the end of the calendar years indicated was: 1985—46,024; 1986—48,470; 1987—51,344; and 1988—54,263; and

(ii) from eleven localities having their own independent systems (including eight cities: Alexandria, Charlottesville, Danville, Falls Church, Newport News, Norfolk, Richmond and Roanoke; and three counties: Arlington, Fairfax and Powhatan) as of April, 1989 was approximately 12,000.

Signed by my hand this 18th day of December, 1990.

/s/ Robert T. Benton
ROBERT T. BENTON
Ph.D

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF STUART W. CONNOCK

STUART M. CONNOCK, being duly sworn, according to law, states as follows:

1. I am Stuart W. Connock, Secretary of Finance for the Commonwealth of Virginia. I was first appointed to that position in 1984 by then Governor Charles S. Robb, and was reappointed in 1986 by Governor Gerald L. Baliles. I have also served as Secretary of Administration and Finance for former Governor John Dalton; and as Assistant Secretary for Financial Policy and Director of the Department of Planning and Budget for former Governors Dalton and Robb.

2. As Secretary of Finance, I am the chief financial advisor to the Governor. I am responsible for five major agencies delivering financial services to state government, including the Department of Planning and Budget, the Department of Taxation, the Department of the Treasury, the Department of Accounts, and the Department of the State Internal Auditor. Among other things, I am responsible for developing financial revenue forecasts, and the direction and formulation of a comprehensive budget program for the efficient operation of state government for the Governor's consideration. The conclusions contained in this affidavit are derived from the execution of those statutory responsibilities.

3. I have been asked to provide an overview of Virginia's 1990-92 biennial budget, and to provide an assessment of the impact on the budget were a court to order a refund of taxes derived from federal pension benefits in an amount currently estimated to be $397.3 million.

4. *Fiscal Outlook.* The covergence of five issues in the development of the Governor's budget recommendation for the 1990-92 biennium points to intense competition between mandatory spending and available revenues. The five issues are: (1) a softening economy in Virginia and the nation; (2) the cost of tax policy changes enacted by the 1989 General Assembly; (3) the cost of federal mandates in health care and the environment; (4) growth in the number of convicted felons that must be confined in the state's prisons; and (5) budget increases in items such as state employee and faculty salaries, and debt service on previously approved bond issues.

5. *Changes in the Economy.* During the 1980's, Virginia's economy has grown significantly. Population increased by 12.5 percent from 1980 to 1988, four percent above the national population growth rate. Between 1980 and 1987 employment grew twice as fast in Virginia as the United States, increasing 26.4 percent compared with 12.4 percent nationally. Total personal income has increased by 53.4 percent since 1983, placing Virginia eleventh nationally and second in the Southeast. The average wage for all industries in Virginia in 1987 was $384 per week, an increase of 50.6 percent over the 1980 figure of $255. Virginia was one of three states whose outlays for construction were 50 percent above the national average in 1987. But even though Virginia's economy is expected to continue to outperform the national economy, revenue collections for the third quarter of calendar year 1989 indicate a softening in the Virginia economy. The change is most evident in the areas of corporate profits, real estate, net migration, and defense spending.

In real estate, for example, there is evidence of overbuilding in residential and nonresident markets, particularly office structures. Reflecting the downturn in housing sales, state revenues from the recordation tax are down considerably. Net migration declined in Virginia between 1988 and 1989 and indications are that this will continue. Defense spending both in terms of contracting and employment will be adversely affected by the federal government's austerity.

In Virginia, the most recent estimates indicate that the cumulative effect of the economic downturn is a $181 million decline in projected revenues for fiscal year 1990, equivalent to three percent of the annual general fund budget. In response, the Governor has announced a hold on state buiilding projects and has asked selected agencies and institutions of higher education to submit contingency plans to reduce their budgets for the remainder of fiscal 1990.

Current revenue estimates indicate a $219 million decline in projected revenues for fiscal 1991 and 1992.

6. *Revenue Policy Changes.* Tax policy changes enacted by the General Assembly in 1989 have reduced revenues that otherwise would have been available for the 1990-92 budget by $391.1 million. Of this amount, $235 million is attributable to the General Assembly's decision to provide a partial income tax exemption for pension income received by federal retirees, in response to the U.S. Supreme Court's ruling in *Davis v. Michigan* that twenty-three states could not treat the taxation of state and local public pensions differently from federal civilian and military pensions. In Virginia, the *Davis* ruling resulted in the overturning of a practice that had been in effect since 1942. The remaining $156.1 million is due to other tax reform measures enacted by the General Assembly involving tax credits (Virginia coal, low income housing, low and moderate income earners), alterations

to the withholding tax tables, and the transfer of the first $40 million in recordation taxes each year to localities.

The impact of the economic outlook and tax policy changes is a much reduced rate of growth in the 1990-92 budget. With one exception, the growth in each biennial operating budget (general fund) exceeded 22 percent throughout the 1970's and the 1980's. The exception was the 1982-84 budget, which, due to the recession, grew by only 14 percent. Based on available resources, the 1990-92 budget will increase by only 13 percent over the 1988-90 budget.

7. *Federal Mandates.* Congress has imposed numerous requirements upon the states in recent years. Such federal mandates on Virginia will cost an additional $200-$300 million in the next two years. Requirements imposed on the Medicaid program (utilization/inflation; Omnibus Budget Reconciliation Act of 1987; coverage of women and their children up to age 6 under 133 percent of the poverty level) are the most expensive. However, federal mandates in welfare reform, catastrophic care and environmental programs will cost millions more.

8. *Law Enforcement, Drug Prevention and Corrections.* While Virginia has one of the lowest crime rates in the nation; it has one of the higher rates of imprisonment. Arrests have increased, fewer felons are being granted probation and the length of prison sentences has grown. Growth in the number of inmates under state custody in Virginia has averaged almost nine percent per year since 1983, but since last fall inmates in state custody have grown by more than 13 percent. The state's prison population has increased by almost two-thirds since 1980. During the same period the total jail population went up 113 percent. By the end of 1989, an estimated 25,000 people will be incarcerated in Virginia's jails and prisons.

This unprecedented growth in the inmate population in Virginia has driven spending on criminal justice faster

than any other area of state government, except Medicaid. In the last four years, Virginia has increased prison capacity by 44 percent and spent $232 million on building new prisons. Protecting Virginia's citizens accounts for approximately $200 million of Virginia's new costs for 1990-92. New prison and jail construction, costs of law enforcement officials at the State and local levels, increases to the criminal fund and involuntary mental commitment fund and match for federal drug abuse programs are but a few of the areas that must be addressed.

9. *Public Instruction.* Education is a key element in the state-local partnership in Virginia and the level of state assistance to localities for elementary and secondary education is driven largely by application of the statutory Standards of Quality to a model developed by the Joint Legislative Audit and Review Commission. These standards, which spell out pupil-teacher ratios, the funding of inflation, and the basis for establishing competitive teacher salaries, are estimated to require anywhere from $500 million to $600 million above the current budget in 1990-92. In total, education accounts for over half of Virginia's general fund budget.

10. *Summary.* As a result of the present slowdown in the National and state economies, the reduced revenue forecast, and the need to address the federal mandates and current services, present estimates for 1990-92 indicate a potential impact of $219 million in reduced revenues coupled with a loss of $391.1 million due to tax policy changes, resulting in a total revenue decline of $610.1 million at a time when $900 million to $1.1 billion in increased expenditures are sought.

These current estimates will require state agencies to shoulder program reductions. Although revenue estimates and other econmic data are changing and are being refined daily, it appears likely that general fund program reductions ranging between 2 and 6 percent may be necessary, depending on the scope of their application.

To the extent that programs traditionally held harmless are not cut,—medicaid, aid to dependent children, foster care, prisons, mental health hospitals, state police—larger reductions would be required in other areas of government services.

While it now appears that a combination of program reductions and reduced funding recommendations to address federal mandates and high priority issues may be required for the 1990-92 biennium, final information on the budget and any specific proposed reductions will not be available until early January when the Governor submits his proposed budget to the General Assembly.

Signed by my hand this 18 day of December, 1989.

/s/ Stuart W. Connock
STUART W. CONNOCK

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF THE HONORABLE A.L. PHILPOTT, SPEAKER OF THE VIRGINIA HOUSE OF DELEGATES

A. L. PHILPOTT, being duly sworn, according to law, states as follows:

1. I have been a member of the House of Delegates of Virginia from Virginia's Eleventh District since 1958. I am the Speaker of the House of Delegates, and have served as its presiding officer since 1980. I am also Chairman of the House Rules Committee, and have served in that office since 1980.

2. I am informed from information provided by the administration that the amount of the potential tax refund at issue in this litigation to date totals nearly $400 million. In addition, I am aware from information provided by the administration and our own legislative staff researchers that revenue forecasts have decreased, due to the softening of the economy and tax policy changes, and that expenditures for mandated human service programs, and critical law enforcement and educational needs, will increase substantially over the next biennium.

3. The Virginia General Assembly is a part-time, citizen legislature which meets in Session for sixty days in even numbered years (commencing the second Wednesday in January). It is during this Session that the General Assembly receives and considers the Governor's budget

recommendations and adopts the Commonwealth's comprehensive biennial budget. During odd numbered years, the General Assembly meets in a shorter session intended to consider house-keeping measures and the fine tuning of programs adopted during the even numbered years.

4. The magnitude of the relief requested in this litigation is a matter of extreme concern for the members of the General Assembly, especially during this period of decreasing revenues and increasing state needs. A court order granting such relief during the budget planning session could require the implementation of tax increases, program reductions, or both, without an opportunity for the considered study and planning necessary to assess the potential impact of such fiscal policy changes on Virginia's citizens, its localities, and its business and economic environment. If the refund were ordered at some point into the biennium, budgetary ramifications would have to be considered during the short session, or even during a Special Session, at a time when potential revenue raising or program reduction options would be even more limited.

5. Regardless of the timing of any court ordered refunds, the most troubling aspect of the extraordinary relief requested in this case is that it would cause harm to the people and the government of Virginia where they have done no wrong—when they simply have relied in good faith on an element of a revenue raising program which remained unchallenged for nearly fifty years, and then acted promptly to reform that program, to the benefit of the federal retiree plaintiffs in this case, when new judicial interpretations in the law were handed down by the United States Supreme Court.

Signed by my hand this 18th day of December, 1989.

/s/ A. L. Philpott
A. L. PHILPOTT

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF THE HONORABLE STANLEY C. WALKER

STANLEY C. WALKER, being duly sworn, according to law, states as follows:

1. I am Stanley C. Walker, President Pro Tempore of the Senate of Virginia. I have been a member of the Virginia Senate since 1972, and was a member of the House of Delegates from 1964 through 1971. I am Chairman of the Senate Committee on Rules, and the second ranking member of the Senate Committee on Finance.

2. As the President Pro Tempore and as second ranking member of the Senate Committee on Finance, I have dealt for a number of years with issues which involve taxation, general and special revenues of the Commonwealth, and matters concerning the expenditure of state funds. The statements and conclusions contained in the affidavit are derived from my experiences in these legislative capacities.

3. I have been asked to provide an assessment of the Commonwealth's fiscal outlook for the 1990-92 biennium. The combination of slowing revenue growth and substantial spending requirements which are non-discriminatory will force the Governor and General Assembly to pare significantly government operations and services during the next biennium. The result will be that almost no new funds will be available to continue the progress made in

improving the quality of public education, meeting the basic needs of Virginia's most disadvantaged populations, or promoting economic development in the state's most under-utilized regions. Indeed, it is virtually certain that reductions will be necessary in many of the services considered by Virginia's residents to be essential.

4. *Revenue Outlook.* Virginia has been fortunate throughout the 1980's. Economic growth during the period brought healthy revenue growth. Except for the recession-constrained biennium of 1982-84, revenue growth has approximated 20 to 22 percent per biennium over the last 10 years. Growth of that magnitude was necessary, however, because economic growth and population growth came hand-in-hand. And with population growth came increased service demands in transportation, public and higher education, health and human resources, and in public safety. Although population growth and hence increased service demand will continue, revenue growth for 1990-92 is forecast to be only about 13 percent—lower than in any biennium of the 1980's and lower even than during the recession of 1982-84. At that level, new revenue available to deal with all cost increases to be funded in the next biennium—both discretionary and non-discretionary—will be only about half of what they were in 1988-90.

5. *Reasons for Revenue Decline.* The causes of this revenue problem have been well documented. There is mounting evidence of an economic downturn, with declining corporate profits, slowing of housing sales, and weak retail activity. Prospective cuts in federal spending could well exacerbate the problem, since Virginia is highly dependent on federal defense spending. The impact of these economic trends on revenues is made more significant by several legislative decisions to divert general revenue for specific purposes—most notably as tax relief for retirees. Other examples include tax credits granted to low income persons, and tax credits for con-

struction of low-income housing. The combined effect of these will be to reduce by about $400 million the revenue forecast which would be produced based on economic factors alone. Based on current forecasts, total general fund revenue for 1990-92 will approximate $13.00 billion.

6. *Non-Discretionary Spending.* From the $13.0 billion must come all the general fund costs of state government. Base spending carried forward from 1988-90 totals $12.3 billion, leaving inadequate funds available to cover all cost increases to be considered. Three areas will consume virtually all of the available revenue—prison construction, Medicaid increases, and statutorily based aid to localities.

(a) Since 1986, Virginia has increased its prison capacity by about 50 percent, at a lost of more than $230 million. Nevertheless, the Commonwealth faces an increasing deficit of prison space. Current forecasts point to the need to accommodate nearly 5,000 additional prisoners by June 30, 1992. Cost estimates to meet the additional space will approach $170 million. Operating costs for prison facilities already built and coming on-line in 1990-92 will consume another $200 millon. These cost estimates do not account for the need to develop alternatives to incarceration, treatment programs for drug offenders (who comprise over 20 percent of convicted felons), and the need to fund job training and educational programs for inmates. If these costs are factored in, the funding estimates for meeting correctional needs expand proportionately.

(b) Medicaid cost increases are the second major component of non-discretionary spending requirements. Over the last 10 years, the costs of providing Medicaid services have grown astronomically. The focus of the program has changed—largely through federal mandates—from a health service program for low-income individuals to a health program for the elderly and disabled. Many services which were once optional features of Virginia's benefits package are now mandated by federal law. The result is that, at this time, the scope and emphasis of the program is largely non-discretionary. Cost increases associated with federal mandates, along with inflational increases in medical costs could approach $300 million in 1990-92.

(c) Statutorily based aid to localities will consume the remainder of available new revenue. One-third of the state's sales tax proceeds, dedication of recordation tax proceeds, aid to localities with police departments, and state aid for several educational entitlements associated with handicapped children will require over $500 million. Like Medicaid and prison construction and operations, these amounts are non-discretionary.

7. *Remaining Spending Requirements.* Using even the most conservative estimates of high priority spending requirements, the minimum remaining needs list exceeds $900 million. Included in this total are minimum increases in state aid for public education, minimum salary increases for faculty and classified employees, funding of a maintenance program for state buildings, additional law enforcement initiatives to fight drug-related crime, and proposals to improve funding of community mental health services. The clear reality is that there will not be sufficient revenue to deal with these increased needs, at even a minimal level.

8. *Options for Addressing the Budget Problem.* There are 3 generic options for dealing with the budget problems facing the Commonwealth: (1) reduce base budgets; (2) postpone discretionary spending; and (3) pursue additional revenues. None offers an easy choice. Almost 50 percent of the Commonwealth's budget is distributed as aid to localities. Another 13 percent is composed of aid to needy individuals, much of which is driven by federal requirements. About 10 percent goes for highly sensitive services such as law enforcement and adult corrections.

About 1 percent is debt service. And half of the remaining total is aid for higher education. To balance a resource shortfall exceeding $800 million—the extent of Virginia's budget problem—would require across-the-board cuts of about 7 percent. Because much of the budget is not discretionary spending, however, cuts on non-exempt programs and services would have to be much larger. Regardless of which programs are exempt, however, the impact of balancing an $800 million budget problem will be serious, and long-lasting. If the court were to compound this difficulty by requiring refund of the $397 million under dispute in this case, the impact would require measures which could well cause great hardship for the people and the government of Virginia.

Signed by my hand this 18 day of December, 1989.

/s/ Stanley C. Walker
STANLEY C. WALKER

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF HUNTER B. ANDREWS

HUNTER B. ANDREWS, being duly sworn, according to law, deposes and states as follows:

1. I, Hunter B. Andrews, am Chairman of the Finance Committee of the Senate of Virginia. I have been a member of the Virginia Senate since 1964, a member of its Finance Committee since 1968, and Chairman since 1986.

2. As Chairman of the Senate Finance Committee, I preside over the Senate Committee which has responsibility for taxation, general and special revenues of the Commonwealth, and all matters concerning the expenditure of state funds. The statements and conclusions contained in the affidavit are derived from my experience in this legislative capactiy.

3. I have been asked to provide an assessment of the Commonwealth's revenue and budget outlook for the 1990-92 biennium. The Commonwealth faces a resouurce shortfall in the 1990-92 biennium. A complete analysis of the fiscal outlook shows that spending requirements will exceed available resources by more than $800 million in 1990-92, and could well exceed revenue by as much as $1.0 billion. The roots of the resource shortfall can be traced to the interrelated effect of three conditions: (1) a general slowdown in economic growth statewide, coupled with the diversion of significant amounts of revenue for tax relief

and aid to localities; (2) the fiscal impact of federal mandates and increased utilization of Medicaid, an entitlement program for which very little state flexibility remains; and (3) a growing and serious shortage in the Commonwealth's capacity to house convicted felons.

4. *Revenue Forecast.* Virginia's current revenue forecasts indicate a slowing of economic growth in 1990-92, compared to the post-recession 1980's. A slowing of housing starts, a decline in corporate profits, and slowing in migration into Virginia foreshadow continuing economic concern. While not unique to Virginia, this slowdown will have a disproportionate effect on the Commonwealth whose population and demand for government services is increasing.

The economic slowdown has been compounded in 1990-92 by the diversion of substantial amounts of general fund revenue for tax relief and aid to localities. Preferential tax relief granted to retirees in 1989 will reduce 1990-92 collections by more than $230 million; income tax credits for low-income persons will reduce collections an additional $56.6 million; dedication of recordation tax proceeds as aid to localities will reduce general revenues by another $80 million; and several smaller tax policy changes will reduce revenues by an additional $22.4 million—a total reduction of $389 million in funds which otherwise would be available to the general fund.

The combined effect of an economic slowdown and revenue diversion for tax relief and aid to localities will be a significant reduction in revenue available for appropriation in 1990-92. Revenue growth will likely approximate only about 13 percent more than in 1988-90—lower than in any biennium in the 1980's, and lower even than the 1982-84 period, which was dominated by a national recession.

5. *Federal Mandates.* Fiscal constraints at the federal level have led increasingly to actions which have shifted program and fiscal responsibilities to the states. A principal example of this is Medicaid, a health-care entitlement program serving low-income and disabled individuals. Expenditure growth for Medicaid has been staggering. Increases have been fueled by the twin forces of the increased costs of medical care and federally mandated expansion of program eligibility. In 1990-92, Medicaid will require nearly $300 million over current expenditures. Because Medicaid is an entitlement program, the Commonwealth has almost no option about service delivery. Funding is therefore non-discretionary, and must be provided.

6. *Prison Population.* The third fiscal pressure facing the Commonwealth involves corrections. Since 1986, the Commonwealth has funded close to a 50 percent expansion of its adult prison capacity. At the same time, and in spite of its best efforts, prison overcrowding has increased —both in state prisons and in local jails. Current forecasts indicate that nearly 5,000 additional prisoners will need to be housed by June 30, 1992. The long-term prospect is for continuing steep increases in prisoners.

The capital cost of meeting the bed demand in 1990-92 will exceed $75 million, and could well approach $170 million. The cost of operating these facilities and others which will open during 1990-92 will exceed $200 million. Expansion of treatment programs and alternatives to incarceration will drive this total still higher. Like Medicaid, correctional costs are non-discretionary, and must be dealt with.

7. *State Responses to the Budget Outlook.* The Commonwealth's options for dealing with its resource shortfall are limited. The base budget for operating state programs, without considering either non-discretionary or discretionary spending increases, totals $12.3 billion. If revenue forecasts are accurate, and past experience has shown them to be, available revenue will approach $13 billion. The limited revenue available will be inadequate to fund Madicaid cost increases, additional operating and

capital costs associated with housing state prisoners, all increases in aid to localities (including aid to public education), salary increases (if any) for faculty and classified employees, and all other funding increases which will be required. When even a conserative list of spending requirements is tabulated, it exceeds available revenues by more than $800 million.

The options for dealing with a resource shortfall of this magnitude are limited. The Commonwealth may reduce on-going state programs, defer costs and spending whenever possible, attempt to shift the cost of services more and more to service recipients and clients, and explore ways of producing additional revenue.

Reductions in on-going state programs are not produced without significant effects on service recipients and localities. Fully 46 percent of the Commonwealth's general fund revenues flow directly as aid to localities. Another 13 percent is spent as need-based assistance to individuals, including Medicaid. About 1 percent is debt service on outstanding bonds and another 10 percent is spent on sensitive services like corrections and state police. The remaining 29 percent comprises the balance of state functions and activities, including higher education. A shortfall of $800 million could require across-the-board reductions of nearly 7 percent. Because much of the budget represents non-discretionary outlays, however, some programs would have to be exempted. The result would be deeper cuts in programs and agencies not exempt.

In a state with a growing population and hence an increasing standard for government services, the impact of resource shortfall will be severe. If the Court were to require a refund of taxes derived from federal pension benefits in an amount of the shortfall would be increased by half. The magnitude of this combined resource shortfall would force reductions across all areas of state

government—including aid to needy individuals, state support of localities, and essential government services, such as adult corrections.

Signed by my hand this 18th day of December, 1989.

/s/ Hunter B. Andrews
HUNTER B. ANDREWS

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF THE HONORABLE ROBERT B. BALL, SR.

ROBERT B. BALL, SR., being duly sworn, according to law, states as follows:

1. I am Robert B. Ball, Sr., Vice Chairman of the House of Appropriations Committee of the Virginia House of Delegates and Chairman designate effective the 1990 session of the General Assembly. I have served in the House of Delegates since 1972. I was first appointed to the House Appropriations Committee in 1974. I am designated to become Chairman of the Committee, by appointment of the Speaker of the House of Delegates, on January 10, 1990.

2. As Chairman of the House Appropriations Committee, I will be responsible for leading the Committee's efforts to review and amend the Governor's 1990-92 spending proposals for approval by the House of Delegates, and I will lead the House budget conferees in formulating a final House/Senate agreement on the budget. The conclusions stated in this affidavit are derived from information made available to me from executive budget analysts, and legislative budget and finance analysts.

3. I have been asked to provide an overview of Virginia's 1990-92 biennial budget, and to offer my assessment of the impact on the budget if a court were to order

the refund of taxes derived from federal pension benefits which amounts at this time to an estimated $397.3 million.

4. *Growth in State Revenues.* In preparing the 1990-92 biennium budget, it is apparent that several factors will combine to make it very difficult for the Governor and the General Assembly to arrive at a spending package in balance with available revenues. Recent tax policy changes have reduced anticipated revenues by nearly $400 million which would otherwise be available for spending. In 1989 the General Assembly reduced the 1990-92 revenue stream by enacting a pension income subtraction (which accounts for $235 million of this decline), a tax credit for purchasing Virginia coal, a low income housing credit, a transfer of state collected recordation taxes to local governments, revised income tax withholding tables, and an income tax credit for low and moderate income earners.

At the same time, Virginia's economy is now showing signs of a weakening national economy. Tax collections for the first four months of this fiscal year were actually less than the first four months of the prior year. While still likely to outperform the nation, Virginia's economic growth is now projected to be less than the official forecast approved by the 1989 General Assembly. Slow growth combined with a reduced tax structure will cause 1990-92 revenues to grow by roughly 13 percent over the 1988-90 biennium. This is the lowest forecast of Virginia revenue growth in two decades.

5. *Required State Spending.* Congressional efforts to reduce the federal deficit have shifted a greater burden to the states for funding several federal/state programs, particularly human services. Virginia's increased responsibilities for funding Medicaid, Welfare Reform, catastrophic health care and environmental programs will cost an additional $200-$300 million in 1990-92. In addition, the state's statutory requirements for funding the

public school Standard of Quality (the school aid funding formula), including teacher salary increases, will cost over $500 million above the base budget. According to the Governor's Commission on Prison and Jail Overcrowding, new construction and operating costs to alleviate overcrowded prisons and jails will cost an additional $421 million over the next two years. Another $1.2 billion will be required in 1992-94.

6. *Impact On State Programs.* The combination of reduced revenue growth and new requirements for state spending could require the base budgets of state agencies to be cut across the board by at least 5 percent in each year of the 1990-92 biennium. If certain high priority human services and safety programs are held harmless, such as public school funding, Medicaid, Aid to Families with Dependent Children, foster care, prisons, and law enforcement, the amount of cuts to the remaining programs would be significantly greater.

In my judgment, state agencies will not be able to absorb further budget reductions beyond those now foreseen for the coming biennium without seriously eroding state services. Cuts similar to these were enacted in 1982-84 during the Robb administration. Since then, most state agency budgets have been "level funded." This means that nonpersonnel costs have simply been held constant without adjustments for inflation. In general, only personnel costs have been advanced to pay for employee salary increases approved by the General Assembly.

If the court were to require the Commonwealth to refund nearly $400 million to plaintiffs, additional budget cuts would have to be enacted, placing critical state/local programs in jeopardy. For example (and this partial listing is not intended to presume what the Governor or the General Assembly in fact will propose), public school funding could be cut. In spite of state and national objectives to improve teacher salaries and our interna-

tional competitiveness in education, the steady progress made in state assistance to local school divisions in the last ten years could be reversed. The Commonwealth's objectives to alleviate overcrowding in prisons and jails could be put on hold, exacerbating already dangerous conditions. State assistance to local law enforcement agencies could be reduced, retarding the Commonwealth's war on drugs. Recent initiatives to create a revolving loan fund to rehab housing for low and moderate income families could be suspended, and repairs and corrective maintenance on buildings and grounds at state facilities around the Commonwealth could be suspended.

Signed by my hand this 10 day of December, 1989.

/s/ Robert B. Ball, Sr.
ROBERT B. BALL, SR.

(Notary Omitted in Printing)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF ALEXANDRIA

(Title Omitted in Printing)

AFFIDAVIT OF THE HONORABLE C. RICHARD CRANWELL

C. RICHARD CRANWELL, being duly sworn, according to law, states as follows:

1. I have been a member of the Virginia House of Delegates from the Fourteenth District since 1972. I served as Ranking Member of the House Finance Committee from 1983 to 1987, and presently serve as Chairman of the House Finance Committee.

2. The House Finance Committee is responsible for considering and recommending to the full House tax policies and legislation determining the composition of Virginia's state tax programs, which sets the level of state revenue collections.

3. I am informed from information provided by the Administration and my committee staff that the amount of the potential tax refund at issue in this litigation to date totals nearly $400 million. I am further informed that interest on this total continues to accrue at an amount estimated to be $3.4 million per month. In addition, I am aware from information provided by the Administration and my Committee staff that revenue forecasts have decreased for the 1990-92 biennium, due to the softening of the economy and tax policy changes, and that expenditures for mandated human service programs, and critical law enforcement and educational needs, will increase substantially over the next biennium.

4. A court order granting the refund relief requested in this litigation could require revenue increases, program reductions, or both, to absorb the loss. In any event, such an order would have a significant impact on all Virginians. Over 80 percent of Virginia's general fund is generated from individual and corporate income taxes, and the state sales and use tax (over half of the state sales and use tax is returned to the localities for education). No other single source of general fund revenues, assuming current rates and bases, generates even half of the refund amount claimed in this litigation. Accordingly, if a revenue increase were required by an order granting refunds to the federal retirees, the impact likely would be felt by a broad spectrum of individual taxpayers.

5. Virginia has a proud history of fiscal responsibility and accountability, and long has been regarded as providing a highly favorable climate for business and industry. For this reason, I believe that if refunds of the magnitude implicated by this litigation were ordered, the General Assembly would address the problems with actions calculated to preserve Virginia's preferred standing in the business and financial community. This means that refund losses likely would be recouped not through tax increases, but through cuts in discretionary programs supported with general fund revenues, such as drug enforcement, housing assistance or state support to local education. The impact on these types of programs could be particularly severe during this period of already declining revenues and rapidly increasing mandated state needs.

Signed by my hand this 18th day of December, 1989.

/s/ C. Richard Cranwell
C. RICHARD CRANWELL

(Notary Omitted in Printing)

COMMONWEALTH OF VIRGINIA

IN THE CIRCUIT COURT
OF THE CITY OF CHEASPEAKE
Courtroom II, South Norfolk

SUBPOENA IN CHANCERY #5459

RE: Application of land owners to Chesapeake Circuit Court for relief from erroneous and unconstitutional assessments of real properties within a portion of Washington Borough of Chesapeake

SERVE: William L. Forbes, City Attorney
Civic Center
Chesapeake, Va.

The party upon whom this writ and the attached paper are served is hereby notified that unless within twenty-one (21) days after such service, response is made by filing in the Clerk's Office of this court a pleading in writing, in proper legal form, the allegations and charged may be taken as admitted and the court may enter a decree against such party, without further notice, either by default or after hearing evidence.

Appearance in person is not required by this subpoena. Done in the name of the Commonwealth of Virginia, this 5th day of March, 1974.

JULIAN R. RAPER
Clerk

By /s/ [illegible]
Deputy Clerk

HENRY E. HOWELL, JR., ESQ., p.q.
908 Maritime Tower, Norfolk, Va.

(Office Address)

VIRGINIA:

IN THE CIRCUIT COURT
FOR THE CITY OF CHESAPEAKE.

In Re: APPLICATION OF LAND OWNERS TO THE CIRCUIT COURT FOR THE CITY OF CHESAPEAKE FOR RELIEF FROM ERRONEOUS AND UNCONSTITUTIONAL ASSESSMENTS OF REAL PROPERTIES WITHIN A PORTION OF WASHINGTON DISTRICT OF THE CITY OF CHESAPEAKE.

APPLICATION FOR RELIEF

FIRST:— Applicants are owners of real properties within the hereinafter described portion of the Washington District of the City of Chesapeake, Virginia:

Beginning at a point on the South side of Military Highway, where the same intersects the Southern Branch of the Elizabeth River; and thence in a generally easterly direction along the southern right-of-way of the said Military Highway to its intersection with the right-of-way of Interstate 404; and thence along Interstate 404 in a southeasterly direction to its intersection with Interstate 64; thence crossing over said Interstate 64 to its southerly right-of-way; and thence along said right-of-way in a northeasterly direction to the property now or formerly Mack Truck, Inc.; and thence following the said property line and the property line of others in an easterly direction to its intersection with Tintern Street; and thence southeasterly along the said Tintern Street to its intersection with Battlefield Boulevard; thence crossing over the said Battlefield Boulevard to its easterly right-of-way; thence southerly along said right-of-way to its intersection with Thrasher Road; thence in an easterly direction along said Thrasher Road to the easterly right-of-way of the Norfolk and Southern Railroad; thence along the easterly right-of-way of said railroad to its intersection with the

northerly property line of property now or formerly owned by the Commonwealth of Virginia, better known as the Greenbrier Prison Farm; and thence along said property line in a northerly direction to its intersection with Greenbrier Road; thence along said Greenbrier Road in a southerly direction to its intersection with the southerly line of the property owned by the Irving Co., better known as Greenbrier Farm Tract; thence in an Easterly and Northerly direction along said property line to its intersection with the City line between Chesapeake and Virginia Beach; thence in a southerly and easterly direction along said corporate line to its intersection with the North Landing Creek; thence northerly and westerly along said creek and the Chesapeake and Albemarle Canal to its intersection with the Southern Branch of the Elizabeth River; thence continuing in a westerly and northerly direction along the last mentioned river to its point of beginning.

SECOND:— Each of the parties named in this Article Second have been aggrieved by the erroneous and unconstitutional assessments of our respective properties, the taxes based upon which assessments became due and payable on December 5, 1972, and we petition this Honorable Court pursuant to § 58-1145 of the Code of Virginia to adjudicate that the said assessments are not uniform in application, are erroneous under the laws of Virginia and unconstitutional under the Constitutions of the Commonwealth of Virginia and the United States. A designation of these applicants and their properties are as follows:

Name	Properties
Capehart, James A. and R.D.	.74 Acres Mill Dam, Map 027 Parcel 0006.
Grimes, Ada D. and Linwood H.	1 Acre Mill Dam, Map 027 Parcel 0007.
Wentz, Benjamin F., Jr. and Virginia L.	1.62 Acres Mill Dam, Map. 027-A-04, Parcel 0011.

THIRD:— Each of the parties named in this Article Third have been aggrieved by the erroneous and unconstitutional assessments of our respective properties, the taxes based upon which assessments became due and payable on December 5, 1973, and we petition this Honorable Court pursuant to § 58-1145 of the Code of Virginia to adjudicate that the said assessments are not uniform in application, are erroneous under the laws of Virginia and unconstitutional under the Constitutions of the Commonwealth of Virginia and the United States. A designation of these applicants and their properties are as follows:

Name	Properties
Anderson, J.R. and Gayle V.	2 Acres, Elbow Road I Butts Lyons Plat, Map 038, Parcel 0018.
	2.25 Acres, H. Butt Lyons Plat, Map 038, Parcel 0017.
	2 Acres, J. Butts Lyons Plat, Map 049, Parcel 0115-J.
Baggott, Elmor C., Jr. and Betty H.	.465 Acres, Portion of Parcel E, Subdivision of Odenhall Farm, Map 029, Parcel 0013.
Blanchard, James W. and Betty Jean	.834 Acres, Great Bridge Blvd., Map 036, Parcel 0226.
Brown, Bertio D. (aka Bertie L)	30 Acres, Elbow, Map 039, Parcel 0003.
	1 Acre, School Prop. Elbow, Map 039, Parcel 0028.
	8.1 Acres, Elbow, Map 039, Parcel 0027.
Butt, Thomas L.	703 Acres, Elbow, Map 50, Parcel 66
	35 Acres, Elbow, Map 39, Parcel 11
	Farm land and residence, Map 39, Parcel 6.
Campbell, Joseph J., Jr.	20 Acres, Turnpike Rd., Elbow, Map 038, Parcel 0079.

Name	Properties
	5 Acres, Turnpike Rd., Elbow, Map 038, Parcel 0080.
Clark, Thomas and Nell	5 Acres Liberty Road Neck, Map 036, Parcel 0072.
Credle, Luther and Gladys, C.	1.8 Acres, Par A. Davis Prop. Map 038, Parcel 0025.
Credle, M. F. and Dorothy E.	2.3 Acres, Par A of C A & E G Davis Prop. Map 038, Parcel 0027.
Croef, Ludford T., Jr. and Lorraine M.	1.91 Acres, Gt. Bridge Blvd., Map 036, Parcel 0120-C.
	12.5 Acres, Gt. Bridge Blvd. Map 036, Parcel 0119.
Cross, Mary E.	12.5 Acres, Kempsville Rd., Map 038, Parcel 0118.
Cutherell, Elmer B. & Dorothy A.	Gt. Bridge Blvd PC, Map 036, Parcel 0159.
	.53 Acres, Gt. Bridge Blvd., Map 36, Parcel 147-B.
Davis, Alice S. and Estate Thomas C. Davis, Sr.	7.42 Acres, Elbow Rd, Map 038 Parcel 0082-A.
	7.58 Acres, Elbw Rd., Map 038, Parcel 0082.
Davis, Garland and Louise	.64 Acres, Elbow Rd, Map 038, Parcel 0034-B.
Davis, John E. and Mary E.	.17 Acres, Pt. 17 Linkorey, Map 037, Parcel 0007.
Davis, Rosa Adell	26.58 Acres, Elbow Rd., Map 038 Parcel 0034.
Davis. Thomas C., Jr.	14 Acres, Elbow Rd., Map 038, Parcel 0081.
DeBaun, Annie R.	That portion of the property described as 85.480 Acres, Mill Dam and Route 13, Parcel 0034, Map 166, as lies within Washington District.
Dillon, Catherine I.	64.50 Acres, Elbow, Map 039, Parcel 029.
Etheredge, Hugh W.	130 Acres, Taylor Tr. Map 047, Parcel 0091.

Name	Properties
Etheredge, Hugh W., et als	266.76 Acres, Gt. Bridge Blvd. Map 047, Parcel 0088.
Etheredge, Iva W.	4.85 Acres, Gt. Bridge Blvd. May 047, Parcel 0099.
Etheredge, James M., Jr.	Map 036 Parcel 170, Gt. Bridge Rd.
Faris, Rose M. and Hoover, S.P.	32.177 Acres, Kempsville Rd. Nr. Butts Sta., Map 038, Parcel 0096.
Finck, William E. and Ann L.	22.650 Acres Neck, Map 035, Parcel 0086.
	.35 Acres, 2 Wm.E. Finck Prop. Map 036-C-04, Parcel 0002.
	.35 Acres, 4 Wm. E. Finck Prop. Map 036-C-04, Parcel 0004.
	18 Oak Grove Homes, Map 048-B-02, Parcel 0018.
	1.06 Acres Parr Farm, Map 027, Parcel 0019
	34 Oak Grove Homes, Map 048-B-02, Parcel 0034.
	11.35 Acres, Gt. Bridge Blvd. Map 046, Parcel 0133.
	33.10 Acres, Gt. Bridge Blvd. Map 036, Parcel 0021.
	34.089 Acres, Neck, Map 035, Parcel 0085.
Godfrey, M. L. Jr. and Marjorie D.	.45 Acres, Nr. Butts Station PC, Map 037, Parcel 0048.
	3.92 Acres, Nr. Butts Station, Map 037, Parcel 0047.
	Nr. Butts Station, Map 037, Parcel 0049.
Gower, L. M. Sr. and Bertha S.	1.04 Acres, Tr. 2 B. Griffin Plat, Map 038, Parcel 0020-A.
Hall, James G. and Cleo H.	3 Acres, Elbow Rd. Par A & B E.H. Pugh Plat, Map 038, Parcel 0056-J.

Name	
Harrison, Earl J. and Betty O.	.50 Acres, Pt. R.O. Croel Prop., Map 036, Parcel 0128-B.
Harrison, Graham & Matilda	Tract 13 Old Farm, Map 036, Parcel 0126.
Harrison, Graham R. and Joan	.50 Acres, Elbow, Map 039, Parcel 029-A.
Harrison, J.A. and Lille Mae	.73 Acres, Homestead Blvd., Map 036, Parcel 0129.
Hedrick, Norman L. and Alice	3.05 Acres, Great Bridge Rd., Map 036, Parcel 0268.
Hollowell, Norman Ray	1.87 Acres, Pt. 17 Linkorey Realty, Map 037, Parcel 0008.
Horner, Clyde and Helen H.	76 Westover, Map 027-A-05, Parcel 0076.
JEH, BHB, AHJR Corps.	3.65 Acres, Iron Bridge Fm. Map 026, Parcel 0035.
	8.5 Acres Cleveland Place, Map 035-A-06, Parcel 0000.
	6 Acres Southern Br. Cleveland Pl. Map 035, Parcel 0079.
	21 Acres Southern Br. Map 035, Parcel 0077.
Jennings, Walter E. and W. Stanley	5.5 Acres, Pt. Est. of Cordelia F. Jennings, Map 039, Parcel 0007-D.
	99.13 Acres, Elbow Road, Map 038, Parcel 0036.
	1 Acre, Elbow, Map 039, Parcel 0019.
Johnson, Charles F. and Judith S.	3.704 Acres Par 1 C.F. & J.S. Johnson Plat, Map 038, Parcel 0056-N.
	4.413 Acres Par 2 C.F. & J.S. Johnson Plat, Map 038, Parcel 0056-O.
	1204 Bryant Drive, Map 38, Parcel 56-M.
	Lot 16 Elpike Manor.
	Lot 17 Elpike Manor.

Name	Properties
Kerlin, John N. & Alice W. Davis	178 Acres, Gt. Bridge Blvd., Map 036, Parcel 0143
Lowry, William L and Mellie T.	15 Acres, Elbow Road, Map 038, Parcel 0083.
McPherson, B. L., Sr.	Tract #8, Great Bridge Blvd.
Manning, Mac E. and Marion C.	Lots 5, 6, Block 13 Norfolk Highlands, Sub 1, Map 020-A-01, Parcel 13-0005.
Martin, F. K. and Ruth Wirt	.70 Acres, Pt. Linkorey Realty Par A, Map 048, Parcel 0091-A.
Melson, Julian R.	2.79 Acres, Gt. Bridge Blvd., Map 036, Parcel 0179.
Minter, Irene H. and James M.	1.61 Acres, Elbow, Map 039, Parcel 0022.
	4.93 Acres, Elbow, Map 039, Parcel 0023-A
	89.51 Acres, Elbow, Map 039, Parcel 0020.
Moffatt, Harry A. & Cora C.	1 Acre, Pt. 3 Linkorey Realty Corp., Map 048, Parcel 0104.
	2.4 Acres, Pt. 4 Linkorey Realty Corp., Map 048, Parcel 0103.
Moseley, Indiana (Foreman, Mary)	1.817 Acres, Oak Grove, Map 048, Parcel 0080.
Osmundson, Gary L. and Nancy L.	.59 Acres, Elbow, Map 038, Parcel 0045-A
	.445 Acres, Elbow, Pt N.D. Osmundson Prop., Map 038, Parcel 0045-B
Osmundson, Julius, Executor Estate of Narcissus D. Osmundson	12.11 Acres, Elbow, Map 038, Parcel 0041.
	19.1 Acres, Elbow, Map 038, Parcel 0045.
Outten, George E., Jr. et als	17.31 Acres, Gt. Bridge Blvd. Map 036, Parcel 0182.
Outten, George E., Jr. & Madylon A.	4.44 Acres, Pt. Outten Farm, Map 036, Parcel 0182-A.

Name	Properties
Parker, Henry G. and Florence V.	.5 Acres, Elbow, Map 038, Parcel 0031.
Parker, Randolph P.	21.80 Acres, Elbow, Map 038, Parcel 0037-A
Sanders, E. W. and Thelma G.	10.5 Acres, Elbow Rd. Tr.7, B. Griffin Plat, Map 049, Parcel 0101.
	7.6 Acres, Par. 1 B Griffin Plat. Map 038, Parcel 0019.
	6.4 Acres, Tr. 6B Griffin Plat, Map 049, Parcel 0100.
	12.25 Acres, Tr. 4 B Griffin Plat, Map 049, Parcel 0116.
	2.46 Acres, Tr. 2 Bertha Griffin Plat, Map 038, Parcel 0020.
	19 Acres, Tr. 5 B Griffin Plat, Map 049, Parcel 0099.
Sawyer, James E. and Linda D.	.68 Acres, Elbow Road, Map 038, Parcel 0034-A.
	.4 Acres, Elbow Rd. 210 x 80, Map 049, Parcel 0146.
Sawyer, Victor L.	5.01 Acres, Part Barton Tr. Map 036, Parcel 0206.
Sawyer, William C. and Margaret	22 Acres, Elbow Rd. Pt. V.D. Torbert Prop. Map 049, Parcel 0150-A.
	.34 Acres Elbow Rd., Map 049, Parcel 0148.
	.46 Acres Elbow Rd., Map 049, Parcel 0148.
Smith, Lonnie and Eunice L.	.08 Acres, Pt. 3 Rosalie Brooks Plat, Map 036, Parcel 0109-A.
Smith, M.A. (Annie M.O. Harrison)	.81 Acres, Armstrong Property, Map 038, Parcel 0126.
Smith, Dorsie G. & Mary Anne	4.005 Acres, Armstrong Property, Map 038, Parcel 0127.

Name	Properties
Spencer, Jimmy and Bernice L.	1.4 Acres, 5 Linkorey Plat, Map 048, Parcel 0102-A.
Stokes, Chester S.	5.87 Acres, Mill Dam, Map 027, Parcel 0012.
Tebault, R. L. and Margaret	66.5 Acres, Elbow Rd., Map 039, Parcel 0030.
Thrasher, D. L. and Caroline C.	8.8 Acres, Elbow, Map 038, Parcel 0050-B
Thrasher, Emma P. and D.L. Thrasher, Estate	403.94 Acres, Elbow, Map 038, Parcel 0050.
	15 Acres, Elbow, Map 038, Parcel 0051.
	74.6 Acres, Turnpike Rd., Elbow, Map 038, Parcel 0078.
Torbert, Viola Davis	18.44 Acres, Elbow, Map 049, Parcel 0150.
Vance, Clement B. Estate (Florence V. Parker, Ex.)	49 Acres, Elbow, Map 049, Parcel 0134.
Vanluik, John W. and Edna	52.5 Acres, Elbow Rd., Map 037, Parcel 0038.
	.68 Acre, #1/2 Tr. 13, Linkorey Realty, Map 048, Parcel 0091.
Voliva, E. R. and Flossie M.	Lot 23, Block 67, N.Hglds.Sub.1, Map 020-A-01, Parcel 067-0023.
	Lot 5,6,8,13 Block 65 N.Hglds.1, Map 020-A-01, Parcel 650005.
	24 Blk. 67, N.Hglds. Sub.1, Map 020-A-01, Parcel 067-0024.
	25 Blk. 67, N.Hglds. Sub.1, Map 020-A-01, Parcel 067-0025.
	22 Blk. 67, N.Hglds. Sub. 1, Map 020-A-01, Parcel 067-0022.
	25, 26 and Pt. 27, Blk. 22, N.Hglds, Sub.1, Map 020-A01, Parcel 022-0025.
	21 Blk 67, N.Hglds., Sub. 1 Map 020-A-01, Parcel 67-0021.

Name	Properties
Voliva, Flossie M. (continued)	20 Blk 67, N.Hglds., Sub 1, Map 020-A-01, Parcel 67-0020.
	2 Blk 66 N.Hghlds.,Sub.1,Map 020-A-01, Parcel 66-00002
	9 Blk. 65,N.Hglds, Sub.1,Map 020-A-01, Parcel 66-0009.
	3 and pt. 2 Block 22, N. Highlands Sub.1, Map 020-A-01, Parcel 022-0003.
	7 Blk 65 N. Highlands, Sub.1, Map 020-A01, Parcel 69-0007.
	Pt. 5, Block 22, N. Hglds.,Sub 1, Map 020-A-01, Parcel 022-0005.
	6 Blk. 66 N. Highlds.,Sub 1, Map 020-A-01, Parcel 066-0006
Ward, Algie B.	18.6 Acres, Gt. Bridge Blvd. Map 036, Parcel 0142.
	66.56 Acres, Gt. Bridge Blvd. Map 036, Parcel 0127.
Wells, Perry L. and Ruth K.	1.42 Acres, Elbow, Map 038, Parcel 0048-B
Widmer, Doris Ann	1 Acre, Gt. Bridge Blvd., Map 036, Parcel 0122.
Whealton, Leslie C., Jr.	9.31 Acres, Pat 5 C.C.Upton Tr. Map 036, Parcel 0189.
Williams, William S. and Lillie	1.5 Acres, Gt. Bridge Rd., Map 036, Parcel 0167.
Wirt, Robert C. and Corinne A.	4.65 Acres, 9 Linkorey Realty Corp., Map 048, Parcel 0097.

FOURTH:— In 1964, the City of Chesapeake enacted Code Section 10—44, providing as follows:

> "There shall be an annual assessment of real estate for local taxation in the city, which shall be made as provided in this article."

Pursuant to the law made and provided, the City of Chesapeake proceeded to assess all properties within the

jurisdiction of the City of Chesapeake and upon completion of said assessment did uniformly tax real property throughout said city on the basis of said assessment in or about the year 1967.

FIFTH:— Since 1967 there has been no annual uniform assessment of real estate, but on the contrary the City has adopted a piecemeal segmental assessment methodology that violates the constitution and laws of the State of Virginia, which required all taxes to be uniform upon the same class of subjects within the territorial limits of the authority levying the taxes.

SIXTH:— Commencing in or about 1968, the City of Chesapeake began to break down the City into geographical segments for the purpose of employing the assessment technique of "continuous maintenance" or as the technique is sometimes described "regular maintenance". Contrary to law, this technique was not employed annually on a jurisdictional at large basis, but in the years here involved was applied to the geographical segment in which the appilcant's properties are situated to the exclusion of properties located in the remainder of the City of Chesapeake. Said method of assessment is unconstitutional by reason of being conducted pursuant to a piecemeal segmental assessment methodology. The general description of the geographic segment within which applicants' properties are located and which were subjected to the piecemeal segmental assessment methodology is set forth in Article First hereof.

SEVENTH:— As a result of the aforesaid illegal and unconstitutional assessments applicants taxes on their aforesaid properties were illegally raised.

WHEREFORE, applicants pray that this Court exercise the jurisdiction bestowed upon it by § 58-1145 of the Code of Virginia to grant relief to your applicant taxpayers by

(1) Decreasing that the piecemeal segmental assessment methodology heretofore referred to to be illegal and unconstitutional;

(2) Directing the appropriate officers of the City of Chesapeake, Virginia, to correct the piecemeal segmental assessment methodology;

(3) Directing the proper officers of the City of Chesapeake, Virginia, to refund all such taxes as your applicants have paid in excess of the taxes for the last prior general assessment applied uniformly to the City of Chesapeake at large in or about the year 1967.

/s/ Henry E. Howell, Jr.
HENRY E. HOWELL, JR.,
of Counsel for Applicants Herein.

I hereby certify that I have requested the Sheriff of the City of Chesapeake, Virginia, to serve a copy of the within Application For Relief upon the following: Roberto H. Waldo, Commissioner of the Revenue, City of Chesapeake, Chesapeake, Virginia; Durwood S. Curling, City Manager, City of Chesapeake, Chesapeake, Virginia; William L. Forbes, City Attorney, City of Chesapeake, Chesapeake, Virginia.

/s/ Henry E. Howell, Jr.
HENRY E. HOWELL, JR.

VIRGINIA:

IN THE CIRCUIT COURT
OF THE CITY OF CHESAPEAKE

In Chancery No. 5459

JAMES A. and R. D. CAPEHART, *et al.*,
Applicants,

v.

CITY OF CHESAPEAKE, VIRGINIA,
Defendant.

DEMURRER

The defendant City of Chesapeake, Virginia, by counsel, says that the Application for Relief is not sufficient in law for the following reasons:

(1) In the event this Court should find, in a proper proceeding for that purpose, that the defendant has employed prior to November 26, 1973, a "piecemeal segmental assessment methodology", as alleged in paragraph SIXTH of the Application for Relief, this finding would not afford any basis for refunds of taxes assessed for 1972 or 1973. In *Perkins* v. *County of Albemarle*, 214 Va. 416 (November 26, 1973), in which the Supreme Court of Virginia held that such assessment methodology violates the uniformity mandate of the Virginia Constitution and upon which the Application for Relief is based, the Court specifically ruled that "As to cities and counties not parties defendant [to that proceeding], our holding has application prospectively only; hereafter, no city or county may employ the implementation methodology we have declared unconstitutional." 214 Va. 416, 418.

(2) The relief sought in paragraphs (1) and (2) of the prayer of the Application for Relief—to-wit, a decree that the alleged "piecemeal segmental assessment methodology is illegal and unconstitutional and an order directing the defendant to correct such methodology—is not authorized or permitted in a proceeding under Section 58-1145 og the Code of Virginia. Section 58-1145 is limited to the correction of an erroneous assessment on the specific property involved.

WHEREFORE, the defendant respectfully prays:

(1) The Application for Relief should be dismissed as failing to state a cause of action.

(2) In the event the Application for Relief is not dismissed, paragraphs (1) and (2) of the prayer be stricken as failing to state grounds for relief that can properly be granted in this proceeding.

CITY OF CHESAPEAKE, VIRGINIA

By _____
Of Counsel

(Certificate of Service Omitted in Printing)

SIXTH JUDICIAL CIRCUIT OF VIRGINIA
Hopewell, Virginia
33860

October 2, 1974

Harry Frazier, III, Esq.
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Suite 603 Maritime Tower
Norfolk, Virginia 23510

Re: Application of Land Owners Etc.—No. 5459
Circuit Court, City of Chesapeake

Gentlemen:

The Court is of the opinion that this case is controlled by Perkins v. Albemarle, 214 Va. 416. The Court will, therefore, sustain the demurrer and dismiss the cause of action. Counsel for the City will prepare an order to this effect, submitted same to counsel for the applicants for endorsement.

It therefore appears that the date of October 21 will be used and is hereby released.

Very truly yours,

/s/ LIGON L. JONES
Ligon L. Jones

LLJ:cpm

cc: William L. Forbes, Esq., City Attorney
Julian R. Raper, Clerk of the Circuit Court

VIRGINIA:

IN THE CIRCUIT COURT
OF THE CITY OF CHESAPEAKE
On the 16th day of October, 1974

No. 5237-Appl.

IN RE: APPLICATION OF LAND OWNERS, ETC.

FINAL ORDER

The Court, upon consideration of the Application of Land Owners filed pursuant to Section 58-1145 of the Code of Virginia of 1950, as amended, the Demurrer of the City of Chesapeake filed in response thereto, Memoranda of Law heretofore submitted and arguments of counsel, is of the opinion that the Application fails to state a cause of action upon which relief can be granted and doth ADJUDGE, ORDER and DECREE that the Demurrer is hereby sustained, the Application is hereby dismissed and the relief prayed for therein is hereby denied, to which action of the Court applicants objected and excepted.

ENTER:

/s/ [Illegible]
Judge

11/16/74

We ask for this:

/s/ William L. Forbes
Counsel for the City of Chesapeake

Seen and objected to:

/s/ William E. Howell
Counsel for Applicants

VIRGINIA:

In the Supreme Court of Virginia held at the Supreme Court Building in the City of Richmond on Monday the 12th *day of* May, 1975.

The petition of James A. Capehart and other owners of real property within the City of Chesapeake, Virginia, for a writ of error to a final order entered by the Circuit Court of the City of Chesapeake on the 16th day of October, 1974, in a certain proceeding then therein depending, entitled, *In Re: Application of land owners to the Circuit Court of the City of Chesapeake for relief from erroneous and unconstitutional assessments, etc.*, having been maturely considered and a transcript of the record of the final order aforesaid seen and inspected, the court being of opinion that there is no reversible error in the final order complained of, doth reject said petition, and refuse said writ of error, the effect of which is to affirm the final order of the said circuit court.

Record No. 750163

A Copy,

Teste:

HOWARD G. TURNER
Clerk

By:/s/
Allen L. Lucy
Deputy Clerk

IN THE SUPREME COURT OF VIRGINIA

No.

HENRY HARPER, *et al.*,
Appellants,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Appellee.

PETITION FOR APPEAL

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Attorneys for Appellants

June 11, 1990

IN THE SUPREME COURT OF VIRGINIA

(Title Omitted in Printing)

ASSIGNMENTS OF ERROR

1. The court below erred in eschewing the plain language of Virginia's statutory tax refund provisions when it concluded that it could deny federal retirees refunds of unconstitutional taxes by accepting the fiction that the taxes were constitutional when exacted.

2. The court below erred in concluding that it needed to analyze retroactive versus prospective-only application of *Davis* v. *Michigan*, 109 S.Ct. 1500 (1989) (declaring Michigan's discriminatory taxation of federal retirees unconstitutional), and it further erred in its application of that analysis to conclude that *Davis* v. *Michigan* should be applied prospectively only.

3. The court below erred in concluding that refunds to federal retirees of income taxes for the 1988 tax year, which were not assessed until *after Davis* v. *Michigan* was issued, could nonetheless be withheld on the basis of prospective-only application of that decision.

Supreme Court, U.S.
FILED
JUL 17 1992
OFFICE OF THE CLERK

No. 91-794

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF FOR PETITIONERS

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QUESTION PRESENTED

Whether this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

PARTIES TO THE PROCEEDING

Petitioners are 420 civil service and Armed Forces retirees (predominantly members of the Virginia Federation of Chapters of the National Association of Retired Federal Employees and the Military Retirees Taxpayers Association) who have paid state income tax on their federal annuities to the Commonwealth of Virginia. A list of individual petitioners appears at Pet. App. E. at 22a.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF FOR PETITIONERS

OPINIONS BELOW

The opinion of the Supreme Court of Virginia (Pet. App. A at 1a-5a) is reported at 410 S.E.2d 629. This Court's order remanding this matter to the Supreme Court of Virginia (No. 90-1685, June 20, 1991, Pet. App. B at 6a) is reported at 111 S.Ct. 2883. The prior decision of the Supreme Court of Virginia (Pet. App. C at 7a-17a) is reported at 401 S.E.2d 868. The decision of the trial court, the Circuit Court for the City of Alexandria (Pet. App. D at 18a-12a) is unpublished.

JURISDICTION

The Supreme Court of Virginia issued its opinion on remand from this Court affirming its denial of petitioners' entitlement to tax refunds on November 8, 1991. The petition for certiorari was filed on November 15, 1991 and granted on May 18, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1257(a).

STATEMENT

In *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), this Court held that 4 U.S.C. § 111 and the constitutional doctrine of intergovernmental tax immunity, as derived from the Supremacy Clause, prohibit states from taxing federal annuitants more harshly than state annuitants. The Commonwealth of Virginia, like Michigan and twenty-one other states, exempted from state income taxation annuities of retired state and local employees while taxing annuities of retired federal employees. *See* Va. Code § 58.1-322(c)(3) (1984). Petitioners are retired federal employees, both civil service and military, who paid Virginia state income tax on their federal annuities.

Following this Court's decision in *Davis*, petitioners filed tax refund actions in various circuit courts in Virginia. These actions were consolidated before the Circuit Court for the City of Alexandria. Refunds were claimed for tax years 1985, 1986, 1987 and 1988.

The procedural framework in Virginia for a refund action is straightforward. Under state law, taxpayers are entitled to seek refunds of taxes that have been "erroneously or improperly assessed." Code of Virginia § 58.1-1826 (1985). Applications for refunds must generally be made within three years of the assessment. Code of Virginia § 58.1-1825 (1985). However, Virginia en acted a special statute of limitations to govern claims for *Davis*-type refund claims: applications for refund of post-1985 taxes may be made up to one year from the date of the final judicial resolution of whether Virginia must refund these taxes. Va. Code § 58.1-1823(B). Virginia law contains no "protest" requirement as a prerequisite for tax refund claims. *See* Va. Code § 58.1-1826.

The Circuit Court for the City of Alexandria denied petitioners' refund claims based upon its view that this Court's decision in *Davis* was to be applied prospectively-only pursuant to the *Chevron* analysis.[1] Pet. App. D at

20a. Petitioners appealed to Virginia's Supreme Court, which affirmed the trial court's analysis and holding. Pet. App. C at 17a.

In *Harper v. Virginia Department of Taxation*, 111 S.Ct. 2883 (1991), this Court vacated and remanded the decision of the court below, which denied petitioners tax refunds upon prospective-only application of *Davis*. The Court directed that the Virginia Supreme Court reconsider its decision in light of *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991). After reconsideration in light of *Beam*, the court below affirmed its prior decision in all respects. This Court granted the petition for certiorari on May 18, 1992.

SUMMARY OF THE ARGUMENT

In *Davis v. Michigan Department of Treasury*, 489 U.S. 803, this Court applied the unambiguous language of 4 U.S.C. § 111 and settled notions of intergovernmental tax immunity to invalidate Michigan's discriminatory taxation of federal annuities. When petitioners' case first came before the court below, that court relied on *Chevron Oil Co. v. Huson*, 404 U.S. 97, to conclude that *Davis* did not apply retroactively. This Court vacated and remanded that decision for further consideration in light of *Beam*; on remand the court below reaffirmed its *Chevron* analysis, concluding that *Beam* was inapposite. In both respects the court below erred.

1. The ruling in *Beam* is straightforward: if this Court applies the rule of law announced in a case to the parties before it, as a matter of equality and *stare decisis* that ruling must be applied by all other courts. There can be no real dispute that *Davis* was so applied: as a result of this Court's ruling, Mr. Davis received a refund. Nonetheless, the court below held that it need not apply *Davis*—it reasoned that because Michigan conceded that a refund was the proper remedy for the in-

validation of its tax, this Court's determination to apply its ruling to the parties before it was not "precedent." In so holding, however, the court below plainly erred: it matters not how or why this Court determined to apply its ruling in *Davis*. It matters only that it did. Under *Beam*, the court below was compelled to apply *Davis*; because it failed to do so, the decision below must be reversed.

2. The decision below is unsustainable for a second and even more fundamental reason. In enacting the Public Salary Tax Act of 1939 (4 U.S.C. § 111), Congress prohibited precisely the kind of discriminatory taxation imposed by the Virginia Department of Taxation ("Department of Taxation"). Under the guise of applying *Davis* nonretroactively, the court below essentially held that 4 U.S.C. § 111 did not become effective in Virginia until 1989, fifty years after it became the supreme law of the land. The Department of Taxation now asks this Court to join the court below in pretending that Congress had enacted 4 U.S.C. § 111 in 1989. Rudimentary notions of separation of powers require this Court to honor and enforce Congress' lawful enactments: this Court could no more ignore 4 U.S.C. § 111 than it could repeal it. Accordingly, even if this Court were sympathetic to the Department of Taxation's pleas, it nonetheless would have to apply 4 U.S.C. § 111 by its unambiguous terms. For this reason as well, the decision below must be reversed.

3. The decision below rests on a nonretroactive application of *Davis*, *i.e.*, the court below treated this case as one of "pure prospectivity." But the viability of "pure prospectivity" is very much in doubt. In *McKesson Corp. v. Florida Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 51 n.35 (1990), five Justices of this Court held that nonretroactive decisionmaking was not a proper judicial function. That holding, as a matter of *stare decisis*, is binding here. Moreover, even if "pure prospectivity" were extant, that doctrine could at best apply to

cases that break with clear past precedent or are in some other sense revolutionary. *Davis* is not such a case.

Even were *Chevron* analysis appropriate here, however, *Davis* would nonetheless have to be applied retroactively. *Davis* did not establish any new principle of law: rather it merely represented an exposition of the unambiguous terms of 4 U.S.C. § 111 and application of this Court's settled precedent. Moreover, nonretroactive application of *Davis*, and hence nonretroactive application of 4 U.S.C. § 111, would frustrate the core principle of the Supremacy Clause that Congress' acts are the supreme law of the land. So too, it would negate the effect of the intergovernmental tax immunity doctrine, which is to render void taxation beyond Congress' waiver of immunity. Finally, nonretroactive application of *Davis* would be grossly inequitable: the Department of Taxation's claims of poverty and ignorance of the law cannot justify withholding relief from petitioners.

4. The Department of Taxation argues that even if *Davis* must be applied retroactively, this Court may nonetheless deny petitioners a remedy for the unlawful deprivation of property they suffered. That is, the Department of Taxation argues that the cost of refunding the unconstitutional taxes imposed upon petitioners is so great that this Court may deny petitioners relief altogether. This argument defies this Court's tandem holdings in *McKesson* and *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990), which make clear that when a state has been found to have exacted an unconstitutional tax, Due Process requires that the taxpayers be afforded meaningful backward-looking relief. Thus, contrary to the Department of Taxation's assertions, under the Fourteenth Amendment, petitioners are entitled to refunds of the taxes unlawfully imposed upon them.

ARGUMENT

I. *BEAM* REQUIRES THAT *DAVIS* BE APPLIED RETROACTIVELY

The court below denied petitioners refunds of the income taxes unconstitutionally imposed on their federal pensions, concluding that "the *Davis* decision is not to be applied retroactively." Pet. App. at 17a. That is, based upon its notions of equity, the court below treated the discriminatory taxes imposed on petitioners' pensions as if they had been constitutional. In so doing, however, the court below erred: under the rule of *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, *Davis* must be given retroactive effect.

Although there was no majority opinion for the Court in *Beam*, its mandate is unmistakable. In announcing the judgment of the Court, Justice Souter (joined by Justice Stevens) rejected "modified" or "selective" prospectivity:

> [W]hen the Court has applied a rule of law to the litigants in one case, it must do so with respect to all others not barred by procedural requirements or res judicata.

111 S. Ct. at 2448. *See also id.* at 2448 (White, J., concurring in the judgment) ("There [is] no precedent in civil cases applying a new rule to the parties in the case but not to others similarly situated"). Justices Blackmun and Scalia went a step further in their concurrences: they rejected both "pure" and "selective" prospectivity. *See id.* at 2450 (Blackmun, J., concurring in the judgment) and 2451 (Scalia, J., concurring in the judgment). Thus, the rule of *Beam* is that if this Court applies the rule of law it announces in any given case to the litigants before it, then all other courts must similarly apply that rule to litigants before them.

Accordingly, the dispositive issue in this case should have been whether this Court applied the rule of law announced in *Davis* to the parties in that case. Yet on this

point, there can be no real dispute: as a result of this Court's ruling, Michigan paid, and Paul Davis received, a refund of the state income taxes he had paid. *See Davis*, 489 U.S. at 817, *citing Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239, 247 (1931) ("to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund."). *See also Davis v. Department of Treasury*, 446 N.W.2d 531, 531 (Mich. App. 1991) (recognizing that this Court ordered that "plaintiff [shall] receive a refund for overpayment of taxes resulting from this disparate treatment."). This Court considered the validity of Michigan's discriminatory tax scheme, found it unconstitutional, and applied that finding to hold that Mr. Davis was entitled to a refund.

Notwithstanding *Beam's* evident command, the court below found that it was free to determine on its own whether to apply *Davis* retroactively:

> The present case, however, is distinguishable from *Beam*. Although the Supreme Court in *Bacchus [Imports Ltd. v. Dias*, 468 U.S. 263 (1984)] applied its rule retroactively to the litigants in that case, the Court made no such ruling in *Davis*. Indeed, the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated. 489 U.S. at 817.

Pet. App. at 4a. The court went on to hold that because the issue of refunds was conceded by Michigan and not decided by this Court, "we are not foreclosed by precedent from applying the three-pronged *Chevron Oil* test in deciding the retroactivity issue in the present case." *Id.*, *citing Swanson v. North Carolina*, 407 S.E.2d 791, 795, *aff'd on reh'g* 410 S.E.2d 490 (N.C. 1991), *petition for certiorari filed*, 60 U.S.L.W. 3655 (U.S. Mar. 4, 1992) (No. 91-1436).[2]

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[2] The Supreme Courts of Montana and South Carolina have similarly followed *Swanson* to conclude that the refund remedy in

In so holding, the court below misread *Beam*. Foremost, its focus on Michigan's concession that a refund would be the most appropriate remedy for the invalidation of its tax[3] is misplaced. As this Court previously has held, and as *Beam* emphasizes, the substantive question of the constitutionality of a tax and the remedial question arising upon its invalidation are two separate questions. *American Trucking Ass'ns v. Smith*, 496 U.S. at 194; *Beam*, 111 S. Ct. at 2443. Though rarely addressed, a necessary third question is the choice of law question critical to *Beam's* analysis: should the Court apply the rule of law announced in the case to the parties before it?[4]

In *Davis*, the Court held that Michigan's tax violated the Supremacy Clause and 4 U.S.C. § 111. 489 U.S. at 817. Self-evidently, had the Court not invalidated the tax, Michigan's concession would have been of no moment. And, had this Court invalidated the tax, but not applied

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Davis is not "precedent." *See Sheehy v. Montana*, 820 P.2d 1257, 1259 (Mont. 1991), *petition for certiorari filed*, 60 U.S.L.W. 3675 (U.S. Mar. 9, 1992) (No. 91-1473); *Bass v. South Carolina*, 414 S.E.2d 110, 115 (S.C. 1991), *petition for certiorari filed*, 60 U.S.L.W. 3755 (U.S. Apr. 24, 1992) (No. 91-1697).

[3] Michigan did not concede that the Court's decision would apply retroactively; such a concession, in any event, would not have had any force. *See, e.g., Kraft General Foods, Inc. v. Iowa Dep't of Revenue and Finance*, 112 S. Ct. ——, ——, 1992 WL 132445 at *7 (1992) (Rehnquist, C.J., dissenting) (stipulations on questions of law are not binding on the Court). Rather, what Michigan conceded was that its refund statute was adequate to satisfy the mandate of equal treatment and that the Court therefore need not retroactively impose a tax on state retirees. Brief for Appellee at 63, *Davis* (No. 87-1020).

[4] This is the question of "pure prospectivity" left open by the Court in *Beam*. Petitioners submit that this question must always be answered in the affirmative—that the Court is bound to decide cases based upon its best current understanding of the law. *See infra* at 19-20. The Court need not reach this question, however, to reverse the court below.

that holding to the parties before it, that concession also would have been inconsequential. Michigan's concession only became operative upon the Court's invalidation of the tax *and* its application of that holding to the parties before it.

Thus the court below misperceived the nature of this Court's holding in *Davis*. Indeed, its conclusion that "the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund," Pet. App. at 4a, is a *non sequitur*. Michigan's concession may have determined what remedy this Court would provide, but it did not drive the determination that a remedy was required. Regardless of whether *Davis*' holding that refunds were required is "precedent," there can be no dispute that this Court "decided the issue" (Pet. App. at 4a) in *Davis* to apply its substantive holding to the parties before it and require a remedy. Under *Beam*, it is this determination that, as a matter of equality and *stare decisis*, requires that every other court apply *Davis*' substantive holding to the parties before them. 111 S. Ct. 2446.

Moreover, the lower court's inquiry into how and why this Court decided to apply its ruling in *Davis* to the parties before it is misguided. Undeniably, the Court considered remedial issues in *Davis*: it held that Paul Davis was entitled to a refund. 489 U.S. at 817. Yet as *Beam* makes clear,

> *any* consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court.

111 S. Ct. at 2445 (emphasis added). Simply that this Court addressed remedies at all demonstrates that it applied its ruling to the parties before it.

Admittedly, the issue of retroactivity was not mentioned in *Davis*. While the court below took this silence as an invitation for it to decide the retroactivity of *Davis*,

in fact, this Court's silence on retroactivity in *Davis* mandates it retroactive application.

Specifically, as this Court has repeatedly held, the overwhelming presumption is that judicial decisions operate retroactively. *See, e.g., United States v. Security Industrial Bank*, 459 U.S. 70, 79 (1982); *Robinson v. Neil*, 409 U.S. 505, 507-08 (1973). *See also Beam*, 111 S. Ct. at 2442. Thus, if retroactivity is not addressed, then the decision operates retroactively. *See Beam*, 111 S. Ct. at 2445-46 n.2 (whether "the prospectivity issue can . . . be said to have been litigated and by implication actually to have been decided by the [*Bacchus*] Court" was "unnecessary" to the holding in *Beam*. *See also id.* at 2448 (White, J., concurring) ("even if . . . the Court was quite wrong in [applying its ruling in *Bacchus* to the parties before it], that is water over the dam, irretrievably."). Indeed, on this point the Court in *Beam* was unanimous. *See Beam*, 111 S. Ct. at 2451 (O'Connor, J., dissenting) ("Given that the usual course in cases before this Court is to apply the rule announced to the parties in the case, the most reasonable reading of [*Bacchus*' silence on retroactivity] is that the Court followed its customary practice.").

The court below held that "because the retroactivity issue was not decided in *Davis*," it was free to decide it. But as *Beam* makes clear, because the Court in *Davis* "did not reserve the question of whether its holding should be applied to the parties before it," 111 S. Ct. at 2445, *Davis* must "properly be understood to have followed the normal rule of retroactive application in civil cases." *Id.* Thus the court below erred in holding that the retroactivity issue was not decided in *Davis*: this Court did not hold that *Davis* would operate prospectively only; nor did it reserve the issue of retroactivity Accordingly, this Court decided that *Davis* would operate retroactively.[5]

[5] In *Barker v. Kansas*, 112 S. Ct. 1619 (1992), this Court invalidated Kansas' discriminatory taxation of military retirees. As in *Davis*, the Court made no mention of the issue of retroactivity, even though the issue was raised in *amicus* briefs and at oral argument. Thus *Barker*, like *Davis*, is properly understood to operate retroactively.

II. THIS COURT MUST ENFORCE 4 U.S.C. § 111 ACCORDING TO ITS TERMS

Under *Beam's* rubric of choice of law, the Department of Taxation urges the Court to adopt a nonretroactive application of *Davis* and thus to choose some other law to resolve this controversy.[6] That is, the Department of Taxation asks this Court to act as if it had not decided *Davis*, or had decided it another way. But to accept the Department of Taxation's invitation, this Court would have to act as if Congress had never enacted 4 U.S.C. § 111. That this Court may not so indulge the Department of Taxation is as fundamental as *Marbury v. Madison*.[7]

In *Davis*, this Court considered and applied the Public Salary Tax Act of 1939, 4 U.S.C. § 111. Focusing on the "plain language of the statute," 498 U.S. at 808, the Court had "no difficulty" concluding that "civil service retirement benefits are deferred compensation for past years of service rendered to the Government," *id.*, and

[6] Although the court below purports to have applied *Davis* nonretroactively, it made no effort to determine how it would have decided this case had it arisen before *Davis* was decided. Certainly after this Court decided *Memphis State Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983), two years before the first tax year in dispute here, there could be no dispute that Virginia's tax scheme violated the intergovernmental tax immunity doctrine. Indeed, even when enacted, Virginia's statute clearly transgressed constitutional bounds. *See Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 486-87 (1939) (irrespective of "whether the taxed income be salary *or some other form of compensation*," the state's power is only to impose "non-discriminatory" taxes,) (emphasis added). Thus, the decision's characterization as a "nonretroactive" application of *Davis* is inaccurate. Rather, it is merely a "nonapplication" of *Davis*, 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine.

[7] 5 U.S. (1 Cranch) 137, 177 (1803).

thus encompassed within the ambit of 4 U.S.C. § 111. Similarly, the Court dismissed Michigan's "hypertechnical" argument that the statutory prohibition extended only to discrimination against officers or employees, but not retirees. The Court held:

> [T]he overall meaning of § 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the Federal Government, except to the extent that such taxation discriminates on account of the source of compensation.

489 U.S. at 810. "Any other interpretation," the Court held, "would be implausible, at best." *Id.*

Virginia's now-repealed tax was legally indistinguishable from Michigan's: it imposed greater burdens on federal retirees, as compared to state retirees, based solely on the source of compensation. Indisputably, it violated 4 U.S.C. § 111—indeed, the court below so found. *See* Pet. App. at 12a (noting that the General Assembly "had acted to correct the defects in its statute."). Yet under the banner of nonretroactivity, the court below held, and the Department of Taxation now asks this Court to hold, that "Virginia's taxing statute was legitimate." *Id.*

In reality, Virginia's taxing statute violated 4 U.S.C. § 111 as much when *Davis* was decided as it did when Virginia enacted it in 1942. When Virginia began its discriminatoy taxation of federal retirees in 1942, it began taxing beyond the scope of Congress' waiver of immunity. Thus, in view of the unambiguous command of 4 U.S.C. § 111, Virginia's taxing statute was never "legitimate" and it could only be treated as so by ignoring 4 U.S.C. § 111, or pretending that Congress had enacted it in 1989 rather than in 1939.

The Department of Taxation now asks this Court to seize this fiction—it requests that this Court ignore 4 U.S.C.

§ 111 and choose some other law than that enacted by Congress in 1939 to resolve this controversy. Merely stating this proposition betrays its utter invalidity: the Constitution compels this Court to honor and enforce Congress' unambiguous enactments.

This Court's role in cases arising under "the Laws of the United States" is well defined. U.S. Const. Art. III, sec. 2, cl. 1. As this Court recently held in *Stewart Organization, Inc v. Ricoh Corp.*, 487 U.S. 2, 27 (1988):

> If the . . . court determines that a federal statute covers the point in dispute, it proceeds to inquire whether the statute represents a valid exercise of Congress' authority under the Constitution. See *Hanna v. Plumer*, 380 U.S. 460, 471 (1965). If Congress intended to reach the issue before the . . . Court, and if it enacted its intention into law in a manner that abides with the Constitution, that is the end of the matter; "*[f]ederal courts are bound to apply rules enacted by Congress with respect to matters . . . over which it has legislative power.*" *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406 (1967).

(Emphasis added.) There is no dispute here that 4 U.S.C. § 111 "represents a valid exercise of Congress' authority under the Constitution." As this Court held in *Davis*, in enacting 4 U.S.C. § 111, Congress sought to codify the constitutional imperative of the intergovernmental tax immunity doctrine. 489 U.S. at 813. Nor can there be any dispute that "Congress intended to reach the issue" before the Court; again as this Court held in *Davis*, the unambiguous mandate of the statute was to prohibit just the type of discriminatory taxation at issue here. 489 U.S. at 812. Thus, "that [must be] the end of the matter." *Stewart Organization Inc. v. Ricoh Corp.*, 487 U.S. at 27.

Nonetheless, the Department of Taxation asks this Court to exempt it from Congress' express mandate, ar-

guing that enforcement of Congress' will is inequitable (*i.e.* expensive). But even were there merit to the Department of Taxation's equitable plea, this Court could not entertain it: the judiciary has no "license[] to attempt to soften the clear import of Congress' chosen words whenever a court believes that those words lead to a harsh result." *United States v. Locke*, 471 U.S. 84, 95 (1985). *See also Maryland v. United States*, 381 U.S. 41, 53, *vacated on other grounds*, 382 U.S. 159 (1965) ("It is nevertheless our duty to take the law as we find it, remitting those aggrieved to whatever requitement may be deemed appropriate by Congress.")

As this Court held in *United States v. Rutherford*, 442 U.S. 544, 555 (1979):

> Under our constitutional framework, federal courts do not sit as councils of revision, empowered to rewrite legislation in accord with their own conceptions of prudent public policy.

Here, Congress has spoken. Even if this Court were sympathetic to the Department of Taxation's pleas of ignorance (of the law) and poverty, it nonetheless would be compelled to enforce the law as enacted by Congress:

> [W]e have no power to change deliberate choices of legislative policy that Congress has made within its constitutional powers. Where congressional intent is discernible . . . we must give effect to that intent.

Sinclair Refining Co. v. Atkinson, 370 U.S. 195, 215 (1962), *rev'd on other grounds*, *Boys Market, Inc. v. Retail Clerk's Union, Local 770*, 398 U.S. 235 (1970). Such is this Court's constitutional role, *see Norfolk & W. Ry. Co. v. American Train Dispatchers Ass'n*, 111 S. Ct. 1156, 1163 (1991) ("if the intent of Congress is clear, that is the end of the matter; for the court must . . . give effect to the unambiguously expressed intent of Congress"), and such has it always been. *See Brown v. Barry*, 3 U.S. (3 Dall.) 365, 367 (1797) ("the intention of the legislature, when discovered, must prevail"); *United States v. Fisher*, 6 U.S. (2 Cranch) 358, 386 (1805) (Marshall, C.J.) ("even if great inconvenience will result," if "the meaning of the legislation be plain . . . it must be obeyed.")[8]

Against this framework, it is not surprising that this Court has never relied on *Chevron* or any other form of nonretroactive decisionmaking as a basis for refusing to apply a lawful act of Congress. Indeed, of all the cases cited in *American Trucking Ass'ns* as examples of cases in which this Court has applied a rule or remedy nonretroactively, not one is a case involving defiance of a federal statute. That is, in none of those cases did this Court choose to ignore an applicable act of Congress in determining the validity of the challenged conduct.

The majority of the cases cited in *American Trucking Ass'ns*, and the majority of the instances where the issue of retroactivity arises, are constitutional cases. *See e.g., Michigan v. Payne*, 412 U.S. 47 (1973) (Fifth Amendment case holding that state court erred in applying *North Carolina v. Pearce*, 395 U.S. 711 (1969)); *Arsenault v. Massachusetts*, 393 U.S. 5 (1968) (right to counsel case holding that the state court erred in refusing to apply *White v. Maryland*, 373 U.S. 59 (1963), retroactively).[9] Statute of limitations cases, such as *Chevron* and *Saint Francis College v. Al-Khazraji*, 481 U.S. 604, 608-09 (1987), involve tolling of *state* statutes of limita-

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[8] *See also Northwest Airlines, Inc. v. Transport Workers Union of America, AFL-CIO*, 451 U.S. 77, 96 (1981) ("Even in admiralty, however, where the federal judiciary's lawmaking power may well be at its strongest, it is our duty to respect the will of Congress.")

[9] As discussed more fully *infra*, statutory cases are rarely candidates for nonretroactive application because it would ordinarily be the statute, and not a judicial decision construing it, that would establish any "new principle of law." The retroactivity jurisprudence of legislation is distinct from that of judicial decisions. *Security Industrial Bank*, 459 U.S. at 79; *Kaiser Aluminum & Chemical Corp. v. Bonjorno*, 494 U.S. 827 (1990).

tions; they are not cases in which this Court has delayed application of any federal statute. Other federal statutory cases, such as *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 88 (1982) and *Buckley v. Valeo*, 424 U.S. 1, 142-43 (1976), are instances in which this Court, after declaring an act of Congress unconstitutional, stayed its judgment to allow Congress time to cure the defect in its legislation.

The only other major class of statutory cases in which retroactivity has arisen is in Title VII pension cases such as *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris*, 463 U.S. 1073 (1983), and *City of Los Angeles, Department of Water and Power v. Manhart*, 435 U.S. 702 (1978). *See also Florida v. Long*, 487 U.S. 223 (1988). In these cases, after finding a violation of Title VII (42 U.S.C. § 2000e-5), the Court has provided less than full retroactive relief. Yet these cases are not ones in which this Court has used prospective decisionmaking to supervene an act of Congress. Rather, they are cases in which this Court, in fashioning an appropriate remedy, was exercising the broad equitable discretion accorded to it by Congress.[10] Thus, in *Manhart*, the Court reversed the district court's provision of full retroactive relief, holding that "the District Court gave insufficient attention to the equitable nature of Title VII remedies." 435 U.S. at 719. Similarly, in *Norris*, the Court anchored its withholding of retroactive application of its decision upon Title VII's specific remedial provisions. *See id.*, 463 U.S. at 1110-11, (O'Connor, J. concurring) ("Such a prospective holding

[10] 42 U.S.C. § 2000e-5(g) provides:

> [T]he court may enjoin the respondent from engaging in such unlawful employment practice, and order such affirmative action as may be appropriate, which may include, but is not limited to, reinstatement or hiring of employees, with or without back pay . . . *or any other equitable relief as the court deems appropriate.*

Emphasis added.

is, of course, consistent with our equitable powers under Title VII to fashion an appropriate remedy.") These cases do not stand for the proposition that this Court may simply ignore a controlling act of Congress; to the contrary, they demonstrate that this Court will hew to the letter and spirit of the law in adjudicating cases arising under Congress' acts.[11]

Properly viewed, this case is not about retroactive versus prospective application of *Davis*. Rather, it is about application of 4 U.S.C. § 111. Of course there can be no dispute that Congress intended the Public Salary Tax Act of 1939 to become effective well before March 28, 1989, the date this Court decided *Davis*. *See* Public Salary Tax Act of 1939, ch. 59, § 4, 53 Stat. 575 (the "United States hereby consents to the taxation of compensation, *received after December 31, 1938*, for personal services as an officer or employee of the United States," (emphasis added). And, "where the congressional intent is clear, it governs." *Kaiser Aluminum & Chemical Corp. v. Bonjorno*, 494 U.S. 827, 110 S. Ct. 1570, 1577 (1990). While this Court certainly has the authority to ascertain when Congress intends an act to become effective, *id.*, once the law has become operative, it becomes the supreme law of the land, subject only to repeal by a subsequent Congress. Congress has not repealed the Public Salary Tax Act, and, the Department of Taxation's wishes notwithstanding, this Court cannot.

[11] In neither *United States v. Estate of Donnelly*, 397 U.S. 286 (1970), nor *Simpson v. Union Oil Co.*, 377 U.S. 13 (1964), did the Court refuse to apply an act of Congress on retroactivity grounds. Indeed, this Court held that *Simpson* was entitled to retroactive effect. *See Simpson v. Union Oil Co.*, 396 U.S. 13, 14 (1969). Nor in *Allen v. State Board of Elections*, 393 U.S. 544, 571-72 (1969), did the Court sanction a violation of a clear congressional mandate in the name of prospective decisionmaking. Thus no statutory case cited in *American Trucking Ass'ns* stands for the proposition that this Court's retroactivity jurisprudence can trump an unambiguous act of Congress.

The court below decided this case by choosing to ignore 4 U.S.C. § 111 (indeed, in neither of its opinions in this case does the court below even cite to this statute). The Department of Taxation now asks this Court, in the name of "prospective decisionmaking," to choose to ignore it as well. But this Court cannot pick and choose which, among Congress' acts, to apply; rather, the most rudimentary concepts of separation of powers require this Court to honor and enforce Congress' lawful enactments. If this Court can choose to ignore a congressional enactment in any given case because it believes the result would be inequitable, then it has completely usurped Congress' power to legislate. No longer would the Constitution serve as the limit of the legislative power; instead this limit would be the judiciary's concept of equities in any given case. Thus, no longer would ours be a "government of laws." *Marbury v. Madison*, 5 U.S. (1 Cranch) at 163.

Accordingly, in asking this Court to exempt it from the reach of 4 U.S.C. § 111, the Department of Taxation is asking this Court to step well beyond its constitutional bounds. This Court's duty is "to say what the law is," *Marbury v. Madison*, 5 U.S. (1 Cranch) at 177, not, as the Department of Taxation would have it, to pretend that the law is something quite different. Because this Court cannot treat 4 U.S.C. § 111 as if it had never been enacted, but instead must apply it according to its unambiguous terms, the decision of the court below must be reversed.

III. EVEN IF *CHEVRON* ANALYSIS WERE APT HERE, *DAVIS* WOULD NONETHELESS HAVE TO BE APPLIED RETROACTIVELY

In its initial decision in this case, "reaffirm[ed] . . . in all respects" (Pet. App. 5a) after remand from this Court, the court below purported to engage in a *Chevron* analysis to conclude that *Davis* was not to be applied retroactively. Pet. App. 10a-14a. As noted above, *Chevron*

is wholly inapposite under the circumstances of this case: *Beam* requires that retroactive effect be accorded to *Davis*, and fundamental notions of separation of powers preclude this Court from ignoring Congress' unambiguous command. But even beyond these arguments, however, there still remain substantial hurdles before this Court can even reach the merits of the lower court's application of *Chevron* here: this Court must first determine that "pure prospectivity" may ever be appropriate, and, if so, whether the bounds of this doctrine could reach a case such as this.

In his opinion announcing the judgment of the Court in *Beam*, Justice Souter explicitly left open the question of whether "pure prospectivity" remains viable: "We do not speculate as to the bounds or propriety of pure prospectivity." 111 S.Ct. at 2448. *See also id.* at 2449 (White, J., concurring in the judgment) ("To nevertheless 'speculate' about the issue is only to suggest that there may come a time when our precedents on this issue will be overruled.") This Court has grappled with the issue of pure prospectivity for the past four Terms[12], and the issue has proved to be particularly difficult and divisive. Significantly, however, in *McKesson*, five justices of this Court rejected nonretroactive decisionmaking. *See* 496 U.S. at 51 n.35. While two members of the Court in *McKesson* are no longer on the Court, *stare decisis* nonetheless precludes this Court from reversing itself on so ephemeral a basis. *See Planned Parenthood of Southeastern Pennsylvania v. Casey*, 112 S. Ct. ——, ——, 1992 WL 142546 at *19 (1992) (joint opinion of Justices O'Connor, Kennedy and Souter) (" 'A basic change in the law upon a

[12] *See McKesson Corp. v. Florida Division of Alcoholic Beverages and Tobacco*, 492 U.S. 916 (1989) (restoring the case to the calendar for reargument and requesting briefing on the issue of the whether prospective decisionmaking was proper); *American Trucking Ass'ns v. Smith*, 496 U.S. 167; *Beam*; *Allied-Signal Corp. v. Director of Taxation*, 112 S.Ct. 1461 (1992) (requesting rebriefing on the potential issue of prospective application of a decision reversing prior Supreme Court precedent.)

ground no firmer than a change in our membership invites the popular misconception that this institution is little different from the two political branches of the Government. No misconception could do more lasting injury to this Court and to the system of law which it is our abiding mission to serve,'" *quoting Mitchell v. W.T. Grant*, 416 U.S. 600, 636 (1974) (Stewart, J., dissenting)). Accordingly, while *Beam* did not speculate as to the propriety of pure prospectivity, *stare decisis* demands that this Court adhere to the holding in *McKesson* and thus reaffirm that all decisions operate retroactively.

Not only must this Court determine that prospective decisionmaking is a proper judicial function before addressing the lower court's *Chevron* analysis, so too must it determine that the bounds of that doctrine would reach a case such as this. Yet even assuming that pure prospectivity remains viable, it is evident that the scope of that doctrine has been significantly curtailed since its popularization over two decades ago. Indeed, even if "pure prospectivity" were ever appropriate, it could not be in a case such as this, where there is no suggestion that any precedent has been overruled and nonretroactivity is being used as an excuse to withhold refunds of unconstitutional taxes.

Specifically, this Court's recent decisions on retroactivity demonstrate that decisions that do not overturn Supreme Court precedent are not even candidates for prospective-only application. For example, in *Goodman v. Lukens Steel Co.*, 482 U.S. 656, 662-63 (1987), the Court refused to allow tolling of the statute of limitations in a case where the court of appeals had reversed itself and shortened the statute of limitations for bringing claims under 42 U.S.C. § 1981. In *Goodman*, this Court affirmed the court of appeal's selection of the shorter personal injury statute of limitations over that governing contractual actions. The Court found nonretroactive application inappropriate because

> there had been no authoritative specification of which statute of limitations applied to an employee's § 1981 claims, and hence no clear precedent upon which petitioners could have relied when they filed their complaints . . .

482 U.S. at 662-63. The Court did not consider, as at least arguably must have been the case, whether at the time the complaint was filed the issue of which statute of limitations period would apply was one of "first impression whose resolution was not clearly foreshadowed." *Chevron*, 404 U.S. at 106.

Similarly, in both *Ashland Oil Inc. v. Caryl*, 497 U.S. 916, 9—, 110 S. Ct. 3202, 3205 (1990), and *National Mines Corp. v. Caryl*, 497 U.S. 922, 9—, 110 S. Ct. 3205, 3206-07 (1990), this Court held that its decision in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), must be applied retroactively. Rejecting the assertion that any clear precedent had been overruled, and holding that its decision did not amount to resolution of "a wholly new issue of first impression" whose "resolution was not clearly foreshadowed," 110 S. Ct. at 3205, the Court reversed the state court's prospective-only application of *Armco*. Thus it was not enough that the Court extended its precedent into an entirely new area of Commerce Clause jurisprudence or that its decision "paved the way" for an arguable overruling of "a lengthy list of settled decisions." 110 S. Ct. at 3205. Because "*Armco* itself . . . was not revolutionary," *id.*, as a matter of federal law it applied retroactively.

These cases demonstrate that this Court has pulled away from the broadest construction of *Chevron's* notion that a new principle of law may be established "in a case of first impression whose resolution was not clearly foreshadowed." 404 U.S. at 106. It is not enough for purposes of retroactivity that the outcome of a case is debatable. Indeed, if debatable outcomes were the test, then virtually every case this Court hears would pre-

sumptively apply nonretroactively. Yet "the general rule of long standing is that the law announced in this Court's decisions controls the case at bar." *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477, 485 (1989). Rather, if resolution of an issue is doubtful, then there can be no reliance on "clear past precedent" sufficient to invoke nonretroactivity. *Goodman v. Lukens Steel Co.*, 482 U.S. at 662-63. And, absent a break with clear past precedent, only if this Court's extension of existing precedent to answer a novel question is "revolutionary" might nonretroactivity be considered.

In addition to these limitations, it is now apparent that when governmental entities are involved, *Chevron* may only apply in cases overturning precedent of this Court. In *Owen v. City of Independence*, 445 U.S. 622, 654-55 (1980), this Court held that "[e]lemental notions of fairness" dictate that it is fairer to allocate the cost of an unforeseen constitutional development "to the inevitable costs of government borne by all taxpayers," rather than "to allow its impact to be felt solely by those whose rights, albeit newly recognized, have been violated." While this analysis may "not apply when a decision clearly breaks with precedent," *American Trucking Ass'ns*, 496 U.S. at 185, it must apply in all other cases of unforeseen constitutional developments. As *Beam* and *American Trucking Ass'ns* demonstrate, the central theme in retroactivity jurisprudence is *stare decisis*. 111 S. Ct. at 2446; 496 U.S. at 196. But considerations of *stare decisis* do not come into play in cases, such as this, that do not break with established precedent. Thus, absent a clear break with precedent, "[e]lemental notions of fairness" dictate that constitutional decisions of this Court must apply against governmental entities, even if unforeseen.

If "pure prospectivity" remains viable, then this formulation must state its broadest reach: if resolution of an issue is doubtful, nonretroactivity may only be appropriate if the Court's ruling is "revolutionary." However, if

the case pits citizens or taxpayers against a sovereign, retroactivity may only be appropriate if the Court's decision represents a break from clear past precedent. Applying this test to *Davis* indisputably yields retroactive application. Because the Department of Taxation cannot plausibly assert that *Davis* was in any sense "revolutionary," *Ashland Oil* requires that it be applied retroactively. And, because the Department of Taxation does not contend that *Davis* overruled any past precedent,[13] this same result attains under *Owen*.

Petitioners submit that there is no need to engage in a detailed *Chevron* analysis: these factors are dispositive. Yet even were the Court to apply *Chevron* here, it nonetheless could not sustain the decision below. At bottom, the lower court's application of *Chevron* is flawed in every respect.

A. Because *Davis* Did Not Establish a New Principle of Law, It Must Be Applied Retroactively

A decision of this Court may only be applied nonretroactively if, in the first instance, it "establish[es] a new principle of law." *Chevron*, 404 U.S. at 106. This is a threshold test: if the decision announces "an entirely new and unanticipated rule of law," *United States v. Johnson*, 457 U.S. 537, 550 and n.12 (1982), *i.e.*, if the decision is "revolutionary," *Ashland Oil Co. v. Caryl*, 110 S. Ct. at 3204, then it may be a candidate for nonretroactive appli-

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[13] The Department of Taxation's principal argument for nonretroactive application of *Davis* is that its statute had been in effect for 47 years before *Davis* was decided; that because it had been unconstitutionally taxing federal retirees in Virginia since 1942 it should be relieved of its constitutional obligation to refund those taxes for which a timely claim for refund may still be made. Op. Cert. at 7. The statute struck down in *Armco* had been in effect for more than 50 years, yet the Court did not suggest that this fact was even relevant to determining whether *Armco* established a "new principle of law." *Ashland Oil Co.*, 110 S. Ct. at 3205 n.*.

cation.[14] If not, then it must be applied retroactively. *See McKesson*, 496 U.S. at 31 n.15; *Goodman v. Lukens Steel Co.*, 482 U.S. at 654-55.

At the outset, it is difficult to discern how a true statutory case [15] could ever satisfy the threshold *Chevron* test. If Congress has spoken clearly in its statute (as it did in 4 U.S.C. § 111), then any "new principle of law" necessarily must arise from the statute, not from a decision of this Court construing it. Moreover, if Congress' language is ambiguous, then this Court's choosing one of many possible constructions cannot come as such a surprise that it would upset "justifiable reliance" on any one interpretation. Only perhaps in the case where this Court were to reverse a previous statutory construction (separation of powers considerations aside), might there be a case for nonretroactive application of a decision construing a federal statute. *United States v. Estate of Donnelly*, 397 U.S. at 295. Certainly *Davis* is not such a case.

In any event, "a decision of this Court [that does] nothing more than apply settled precedent to different fact situations" must always apply retroactively. *Griffith v. Kentucky*, 479 U.S. 314, 324 (1987). Because *Davis* is no more than an exposition of the plain language of 4 U.S.C.

[14] That is, a new principle of law is established when there is "such an abrupt and fundamental switch in doctrine as to constitute an entirely new rule which in effect replaced an older one." *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 498 (1968). Thus, for a case to establish a "new principle of law," it must present either "a sharp break in the line of earlier authority or an avulsive change which caused the current of the law thereafter to flow between new banks." *Id.*, 392 U.S. at 499.

[15] *I.e.*, interpretation of an Act of Congress. This Court has frequently addressed the retroactivity of constitutional law decisions, including decisions invalidating federal statutes. *See supra* at 15-16. With the exception of Title VII pension cases, which are gauged by a distinct standard, *see Florida v. Long*, 487 U.S. at 230, this Court has at most on a handful of occasions ever addressed whether its construction of an Act of Congress should have retroactive effect.

§ 111, and an application of settled precedent to a new set of facts, it is not a candidate for nonretroactive application.

The holding in *Davis* followed naturally and unexceptionally from settled law. The first aspect of the *Davis* decision—that 4 U.S.C. § 111 applies to both current pay and retirement pay of federal employees—was established by the plain language of the statute. *Davis*, 489 U.S. at 808 n.3 ("[t]he language of the statute leaves no room for doubt on this point."). Moreover, that civil service retirement benefits constituted "deferred compensation" had been established by the Civil Service Retirement Act of 1920, 41 Stat. 614. *See also* 59 Cong. Rec. 6300 (Apr. 29, 1920) (statement of Rep. Hamill: federal pensions "should be looked upon as deferred wages."). Similarly, Michigan's "hypertechnical" argument that Congress consented to the taxation of federal retirement benefits but did not prohibit discriminatory taxation of these benefits was belied by the statutory language:

> The reference to "*the* pay or compensation" in the last clause of § 111 must, in context, mean the same "pay or compensation" defined in the first part of the section.
>
> * * * *
>
> Any other interpretation of the nondiscrimination clause would be implausible at best.

489 U.S. at 810 (emphasis original). Thus, *Davis* concluded:

> [T]he overall meaning of 4 U.S.C. § 111 is unmistakable: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of salaries, retirement benefits, and other forms of compensation paid on account of their employment with the Federal Government, except to the extent that such taxation discriminates on account of the source of compensation.

489 U.S. at 810.

Having concluded that by its plain and unambiguous terms 4 U.S.C. § 111 included retirement benefits within the conditional grant of immunity from state taxation, the Court then went on to determine whether Michigan's tax "discriminate[d] because of the source of pay or compensation." In this regard, the Court concluded that, because of "the similarity of language and purpose between the constitutional principle of nondiscrimination and the statutory nondiscrimination clause," and because "§ 111 was consciously drafted against the background of the Court's tax immunity cases," the "retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxation embodied in the modern constitutional doctrine of intergovernmental tax immunity." 489 U.S. at 813. In this regard, the Court cited *Memphis State Bank & Trust Co. v. Garner*, 459 U.S. at 396-97 (Congress' consent to "nondiscriminatory" state taxation of interest on federal obligations in 31 U.S.C. § 742 is "principally a restatement of the constitutional rule."). Thus the Court proceeded to determine whether Michigan's tax violated the constitutional doctrine of intergovernmental tax immunity.[16]

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[16] The Court recognized that 4 U.S.C. § 111 could also be read to create "an affirmative statutory grant of immunity from discriminatory taxation," 489 U.S. at 813, but saw no need to examine the scope of this statutory immunity. *See South Carolina v. Baker*, 485 U.S. 505, 518 n.11 1987 (the federal government "possesses the power to enact statutes to immunize those with whom it deals from state taxation even if [the] intergovernmental tax immunity doctrine would not otherwise confer an immunity."). The dissent in *Davis* criticized the application of the constitutional doctrine because Michigan's discriminatory tax did not apply exclusively to federal retirees, but instead applied "to the vast majority of Michigan residents." 489 U.S. at 818 (Stevens, J., dissenting). *See also Barker v. Kansas*, 112 S. Ct. at 1626 (Stevens, J. concurring). Yet even if the constitutional immunity did not protect federal retirees, it is evident that the congressional grant of immunity would. In enacting the Public Salary Tax Act, Congress focused on the comparative taxation of compensation of federal and state employees because it was concerned "that considerations of fairness

Here again, the Court applied settled precedent to conclude that Michigan's tax was constitutionally discriminatory. The Court rejected Michigan's contention that the doctrine of intergovernmental tax immunity protected only the federal government and not individuals. "Indeed," the Court held, "all precedent is to the contrary." 489 U.S. 814, *citing, inter alia, Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376, 387 (1960); *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392; *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744 (1961). Finally, the Court concluded "[t]he State offers no reasons for departing from this settled rule, and we decline to do so," (footnote omitted). 489 U.S. at 815.

Having concluded that the plain and unambiguous terms of 4 U.S.C. § 111 encompassed retirement benefits, having concluded that Congress intended to adopt the judicial interpretation of the intergovernmental tax immunity doctrine when it codified that concept (*citing Midlantic National Bank v. New Jersey Dep't of Environmental Protection*, 474 U.S. 494, 502 (1986), and *Morissette v. United States*, 342 U.S. 246, 263 (1952)), having concluded that "all precedent" was to the effect that individuals were entitled to claim the protections of the in-

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demanded *equal tax treatment for state and federal* employees." 489 U.S. at 812 *citing* S.Rep. No. 112, 76th Cong., 1st Sess., 4 (1939); H.R. Rep. No. 26, 76th Cong., 1st Sess., 2 (1939) (emphasis added). "Equal tax treatment" cannot be read to include any "political check against abuse of the taxing power," 489 U.S. at 827, *quoting United States v. County of Fresno*, 429 U.S. 452, 462 (1977). Rather, it envisions a much simpler inquiry: are state employees and federal employees being taxed the same? *See also* S.Rep. No. 112, *supra*, at 9 (the Public Salary Tax Act "provides only for nondiscriminatory taxation of the compensation of public employees and is reciprocal in nature. Thus, whatever burden might be passed on to one government because of the taxation of its employees' compensation by another governmental unit would, in a measure, at least, be offset by the converse application of the proposal.").

tergovernmental tax immunity doctrine, the Court then held that

> [u]nder our precedents, "[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other] must be justified by significant differences between the two classes."

489 U.S. at 815-16, *quoting Phillips Chemical Co.*, 361 U.S. at 383. Finally, the Court held that Michigan's "rational basis" argument was insufficient to meet this test.

In light of *Davis*' reliance on the unambiguous language of 4 U.S.C. § 111 and its precedential underpinnings, the assertion that it constitutes "an avulsive change which caused the current of the law thereafter to flow between new banks," *Hanover Shoe Co. v. United Shoe Machinery Co.*, 392 U.S. at 499, is untenable at best. Nonetheless, the court below held that *Davis* established a new principle of law:

> [I]t is difficult to perceive how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation.

Pet. App. at 12a. While this is a dubious recasting of *Davis*' holding, in fact what the General Assembly easily should have perceived was what Congress provided by law in 1939 and what this Court held in *Phillips Chemical Co.* in 1960:

> [I]t does not seem too much to require that the State treat those who deal with the [federal] government as well as it treats those with whom it deals itself.

361 U.S. at 385. Certainly after this Court decided *Memphis State Bank* in 1983, two years before the earliest tax year in dispute here, the General Assembly could not reasonably expect that its statute would pass constitutional muster.

When Virginia enacted its tax preference for state pensioners in 1942, it did so in the face of a federal statute that unambiguously prohibited discriminatory taxation of federal retirees. Retroactivity analysis involves "[t]he process of reconciling the constitutional interests reflected in a new rule of law with reliance interests founded upon the old," *Lemon v. Kurtzman*, 411 U.S. 192, 198 (1973). If the Department of Taxation blindly relied upon Virginia's statute, without any consideration of 4 U.S.C. § 111 or this Court's intergovernmental tax immunity jurisprudence, then that reliance certainly was not justified. It is not enough, as the Department of Taxation asserts, that it did not foresee the invalidation of its tax. Op. Cert. at 7. *Davis* did not overturn any precedent of this Court; nor, given its precedential underpinnings, is it even a "case of first impression."[17] Rather, because *Davis* merely applied "settled precedent to a new set of facts," *United States v. Johnson*, 457 U.S. at 551, it was inevitable. Accordingly, *Davis* must be applied retroactively.

B. The Purposes Underlying the Supremacy Clause and the Balance of the Equities Here Require that *Davis* Be Applied Retroactively

Even if *Davis* could conceivably be characterized as satisfying *Chevron's* threshold test of establishing a "new principle of law," it nonetheless would have to be applied retroactively. While establishment of a new principle of law is necessary, it is not sufficient to render a decision nonretroactive. Rather, a decision announcing a new

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[17] Of course virtually every case heard in this Court is in some sense a case of first impression: absent some novelty in the case, there would rarely be any need for this Court to exercise its certiorari jurisdiction. But it is not enough for purposes of retroactivity that a case might be the first to construe a given statute—as this Court held in *New York v. Cathedral Academy*, 434 U.S. 125, 130 (1977), the law of retroactivity is not that "every . . . unconstitutional statute, like every dog, gets one bite, if anyone has relied on the statute to his detriment."

principle of law may be applied nonretroactively only if the purposes underlying the constitutional doctrine in dispute would be furthered by nonretroactive application and the balance of the equities favors nonretroactive application. *Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. at 485-86. Nonretroactive application of Davis would frustrate the purposes underlying the Supremacy Clause and the intergovernmental tax immunity doctrine; so too would it work substantial inequity and hardship. Accordingly, *Davis* must be applied retroactively.

1. *The purposes of the Supremacy Clause and the intergovernmental tax immunity doctrine would be flouted by nonretroactive application of* Davis

Chevron requires that a court evaluate the purpose and effect of the legal rule in question and ascertain whether retrospective operation will further or retard the rule's operation. 404 U.S. at 106. The court below concluded that because the Virginia General Assembly had repealed its offending tax statute, and because "Virginia's taxing statute was legitimate until a new rule was announced in *Davis*,"

> the purpose of the intergovernmental tax immunity doctrine already has been fully served, and applying *Davis* retroactively would do nothing either to retard or further the doctrine's purpose.

Pet. App. at 12a. This reasoning is tautological: once this Court decided *Davis*, the Virginia General Assembly had no choice but to repeal its offending statute. Moreover, Virginia's taxing statute was not "legitimate" at any time, either before or after *Davis* was decided. Rather, it could only be "deemed" legitimate by employing the fiction of nonretroactive application of *Davis*. That is, the court below could only conclude that the second *Chevron* factor was in equipoise by assuming the result its *Chevron* analysis yielded.

Even employing this analysis, the court below did not conclude that retroactive application of *Davis* would *retard* the purposes underlying the Supremacy Clause and the intergovernmental tax immunity doctrine. Plainly, however, it ignored the ways in which retroactive application of *Davis* would further the underlying purposes of these provisions; indeed, it ignored the ways in which prospective-only application of *Davis* would flout them.

First, central to the Supremacy Clause is the tenet that federal statutory enactments supervene contrary state laws. *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819). *Davis* rested not only on the principle of intergovernmental tax immunity, but also upon the unambiguous force of the Public Salary Tax Act, 4 U.S.C. § 111. The court below, by asserting the nonretroactivity of *Davis*, has effectively held that 4 U.S.C. § 111 did not apply in Virginia until March 28, 1989 (the day this Court decided *Davis*), fifty years after Congress passed the statute. Delaying the effective date of federal legislation is beyond the power of state courts and legislatures. *See M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) at 436 ("States have no power, by taxation or otherwise, to retard, impede, burden or in any manner control, the operations of the constitutional laws enacted by Congress."). Nonretroactivity of *Davis* would flout the core principle of the Supremacy Clause that federal statutes upon enactment are the supreme law of the land; thus the underlying purpose of the Supremacy Clause mandates *Davis*' retroactive application.

Second, "the effect" of the intergovernmental tax immunity doctrine is to render void state taxes that discriminate against the federal government or those with whom it deals. Specifically, as this Court held in *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. at 752, *quoting Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. at 387, "a discriminatory tax is void and 'may not be exacted.'" Nonretroactive application

of *Davis* would thus negate the intended effect of this doctrine: taxes that "may not be exacted" would nonetheless be retained. For this reason as well retroactive application of *Davis* is required.

Third, allowing states to retain unconstitutionally exacted taxes provides them with a naked financial incentive to tax beyond the bounds of their authority even where, as here, the tax impermissibly drains the federal fisc and well-settled legal principles expose the illegality of the tax at the time it is collected. If anything, states must tread with caution when enacting tax schemes that may impermissibly impact the federal government. *Graves v. New York ex rel. O'Keefe*, 306 U.S. at 488 (Frankfurter, J., concurring). Nonretroactive application of *Davis* would signal states to tax not with caution but with abandon: if a state can hide behind nonretroactivity, it has every incentive to tax beyond its constitutional authority. Retroactive application of *Davis* is thus necessary to remove this perverse incentive.[18]

Finally, retroactive application of *Davis* will cause refunds to be paid to petitioners, and this will directly advance the purposes of the Supremacy Clause and the doctrine of intergovernmental tax immunity. As to petitioners themselves, they have legitimate compensatory interests safeguarded by the Supremacy Clause. *See, e.g., Green v. Mansour*, 474 U.S. 64, 68 (1985) ("Remedies designed to end a continuing violation of federal law are necessary to vindicate the federal interest in assuring the supremacy of the law."). Moreover, the federal govern-

[18] Nonretroactive application of *Davis* would also undermine the system of self assessment of taxes utilized throughout the country. If taxpayers lose confidence in their right to obtain refunds of illegally exacted taxes, then it is only a short step to their losing confidence in the fairness of the tax system as a whole. Thus, nonretroactive application of *Davis* jeopardizes the entire system of self assessment upon which federal, state and local governments depend.

ment, which had been involuntarily subsidizing the employment costs of Virginia and 22 other states for almost 50 years, stands to obtain a substantial portion of any refunds paid to petitioners. Thus, retroactive application of *Davis* will at least partially remedy the constitutional harm suffered by the federal government.

The intergovernmental tax immunity doctrine, at its core, dictates that states may not subsidize their operations through taxation of federal entities:

> Taxes enacted to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

Davis, 489 U.S. at 815, n.4. Yet this subsidy is precisely what Virginia has accomplished through its unconstitutional tax.[19] Thus, in defiance of this underlying purpose of the intergovernmental tax immunity doctrine, for fifty years Virginia has forced the federal government to bear a portion of Virginia's employment costs.

Petitioners paid the unconstitutional taxes to Virginia during the years 1985 through 1988. Similarly, they deducted from their federal income tax the state income taxes they paid. Any refund they obtain will be income to them, subject to federal taxation. *See* 26 U.S.C. § 111. While admittedly the federal government will not be able to obtain recompense for all the involuntary subsidy of states' employment costs it has borne, retroactive application of *Davis* will provide it at least some recovery. There can be no contention that retroactive application

[19] *See Davis*, 489 U.S. at 815 n.4:

> In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefit payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances.

of *Davis* would somehow retard this purpose; to the contrary, this end could only be served by retraction of this involuntary subsidy through retroactive application of *Davis*.

2. *The Balance of the Equities Overwhelmingly Favors Retroactive Application of* Davis

Chevron's final criterion is a balancing of the equities to determine if "injustice or hardship [may be avoided] by a holding of nonretroactivity." 404 U.S. at 107. The court below concluded that "the equities weigh heavily in favor" of nonretroactive application of *Davis*. Pet. App. at 14a. This holding represents the lower court's most egregious error: the equities here overwhelmingly and conclusively favor retroactive application of *Davis*.

At the outset, the equities favor petitioners' compensatory interests over those of the Department of Taxation as a matter of federal law. As this Court held in *Owen v. City of Independence*, 445 U.S. at 654:

> It hardly seems unjust to require a municipal defendant which has violated a citizen's constitutional rights to compensate him for the injury suffered thereby. . . . Elemental notions of fairness dictate that one who causes a loss should bear the loss.

Even accepting the Department of Taxation's contention that *Davis* was not foresecable and that therefore it was merely relying in good faith on its presumptively valid statute, *Owen* nonetheless demonstrates that equity is in petitioners' corner:

> [E]ven where some constitutional development could not have been foreseen . . ., it is fairer to allocate any resulting financial loss to the inevitable costs of government borne by all the taxpayers, than to allow its impact to be felt solely by those whose rights, albeit newly recognized, have been violated.

Owen, 445 U.S. at 655.[20]

[20] The plurality in *American Trucking Ass'ns* distinguished *Owen* as not applying in cases that "clearly break[] with precedent." 496 U.S. at 185. There is, of course, no contention here that *Davis* broke with any precedent of this Court. Neither can *Owen* fairly be limited to a statutory construction of 42 U.S.C. § 1983: it is cast in terms of "[e]lemental notions of fairness," *Owen*, 455 U.S. at 654, the cornerstone of due process.

Federal law aside, it is simply more equitable to place the financial consequences of remedying an unconstitutional income tax upon the government (and thus the citizenry as a whole) than upon the select subclass of taxpayers who have been forced to bear the unconstitutional burden in the first place. Because the Department of Taxation had no right to impose the taxes at issue here, by definition petitioners have paid more than their fair share for the benefits Virginia provided them: the revenue generated by the excessive taxes imposed on petitioners should have been raised by a nondiscriminatory tax upon the populace as a whole.[21] The suggestion that it is somehow more equitable to leave this disparate taxation in place than to remedy it is difficult to fathom.

Indeed, the Department of Taxation's equitable plea is ironic—its principal thrust is that because it had been unconstitutionally taxing federal retirees for 47 years, it should not be required to disgorge the last four years of its ill-gotten gains. Undoubtedly, the sum of its unconstitutional exactions since 1942 exceeds by more than an order of magnitude the amount at stake here.[22] How

[21] Alternatively, Virginia may have elected not to raise the revenue at all, in which case the consequence of its having lower revenues would have been borne equally by all its citizenry.

[22] Because this case was decided on the Department of Taxation's motion for summary judgment, the record does not reflect the amount of the refund claims actually at issue in this suit. The Department of Taxation estimates that its total refund exposure for 192,000 affected federal retirees state-wide to be $440 million: that ratio yields a refund claim of approximately $2,300 per claimant, or slightly less than one million dollars for the 420 named petitioners. While petitioners submit that these numbers are irrelevant to this Court's consideration of this case, it is likely that the De-

it could be inequitable to require Virigina to refund only a small fraction of what it has unlawfully taken is, again, difficult to comprehend.

Moreover, while the Department of Taxation bemoans the cost of complying with the Constitution, it must not be forgotten that its wounds are entirely self-inflicted. The majority of states have avoided Virginia's predicament by not imposing a discriminatory tax on federal retirees. But even aside from the wisdom of imposing this tax in the first instance, Virginia's troubles are of its own making.

Specifically, at least for 1988 state income taxes (that were not due until May 1, 1989), Virginia could have avoided any refund liability simply by imposing a tax at that time on state pensions. *See McKesson*, 496 U.S. at 40 (state may rectify discriminatory taxation either through refunds or retroactive taxation of the favored class).[23] Not only would this have trimmed Virginia's refund exposure by approximately $100 million, but imposing a tax on the pensions of the sixty thousand state retirees would have generated substantial additional reve-

partment of Taxation's estimates are overinflated. *See, e.g.*, J.A. 25 (concluding that although only 134,000 returns indicated any federal pension income, because 43 percent of the returns were for married taxpayers, the total number of federal retirees "could be as many as 192,000."). For this to be so, however, each of the married taxpayers would have to have a spouse who also was a federal retiree. This seems unlikely.

[23] Had Virginia imposed a nondiscriminatory tax on state pensions before May 1, 1989, that would have effected a waiver of immunity under 4 U.S.C. § 111 and negated petitioners' claim for tax year 1988. Arguably, at that time Virginia could also have retroactively taxed all state pensions for 1987 as well, thus halving its refund exposure. *But see McKesson*, 496 U.S. at 39 (taxes imposed beyond grant of immunity must be refunded); *id.* at 40-41 n.23 (beyond some temporal limit, retroactive taxation is unconstitutional). Virginia elected not to follow that path, however, and it is too late for it to do so now.

nue. Presumably for sound political reasons, the General Assembly did not choose to pursue that course. But having chosen the refund route, and thus having eschewed the opportunity to limit its exposure while generating additional revenue, it cannot be heard to complain about the magnitude of the potential refund.

Similarly, the General Assembly's adoption of a special statute of limitations for bringing *Davis*-type claims undermines its equitable plea. Specifically, the General Assembly enacted a provision allowing federal retirees up to "one year from the entry of a final judicial order . . . resolving the issue of the application [of *Davis*] to Virginia income tax" within which to initiate their refund claims. Va. Code § 58.1-1823(B). In *McKesson*, 496 U.S. at 45 and 50, and again in *Beam*, 111 S.Ct. at 2248, this Court acknowledged that states may rely on procedural requirements, such as statutes of limitations, to reduce their exposure to refund claims. Yet by adopting this open-ended statute of limitations, the General Assembly has discarded what no doubt would have proven to be its most effective means of limiting its exposure. Having taken no steps to minimize its exposure (*i.e.*, retroactive equalization of the tax), but rather having taken affirmative steps to maximize it, the Department of Taxation cannot now be heard to argue that the size of the refund liability will have a "disruptive and destructive impact on [Virginia's] planning, budgeting, and delivery of essential services." Pet. App. 14a.

Perhaps the most troubling aspect of the Department of Taxation's equitable plea, however, is that it devolves to the assertion that if the potential refund is large, and money is tight, then the underlying conduct must be legal.[24] Thus, the Department of Taxation's perverse sug-

[24] The Department of Taxation does not explain why the meager state of the fisc at the time the refund claims are litigated should provide a basis for denying relief altogether. It would seem that if

gestion is that the greater the size of the constitutional deprivation, the less the need to remedy it. But the law cannot be that whenever a state is low on cash it can take private property without being troubled by due process of law or just compensation; it cannot be that because the state needed more money (lest essential services be threatened), the taking is constitutional. By this logic, if a taxpayer is short on cash he owes no taxes; if a thief is poor, he takes only what is his.

Moreover, the Department of Taxation's bizzare standard is incapable of reasoned application: there is no gauge by which this Court, or any other court, can determine when a state's cost of complying with the Constitution becomes so great that the underlying deprivation must be deemed constitutional. For example, the court below relied on affidavits of state legislators and executive officers to hold that the estimated size of the refund "potentially" threatened the delivery of "essential state services." Pet. App. 14a. But surely it is not a proper function for the courts to determine which threatened services are essential, or how much of a reduction in funding available for such services is tolerable. Nor would it be proper for the Court to second-guess the legislature's determination to comply with *Davis*' mandate of equal treatment by exempting federal retirees from taxation, J.A. 28, rather than by extending the tax to state retirees, even though the latter course would likely have provided enough revenue to pay the refund liability.

Petitioners need not doubt that there may be no "easy choices," J.A. 37, or that Virginia's reputation for "providing a highly favorable climate for business and industry" may be tarnished if it has to raise taxes to pay

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the state is truly unable to pay for its unconstitutional actions, it must pay what it can, and the remainder when it can. It is a curious jurisprudence that hinges the constitutionality of a state's conduct on the vicissitudes of its budget.

refunds.[25] J.A. 49. But these are choices committed exclusively to legislative discretion; that they may be particularly distasteful or divisive does not alter the fact that courts are uniquely ill-equipped to make them. This Court cannot say whether Virginia should reevaluate the tax policy changes enacted in 1989 that reduced its revenues by $391.1 million (J.A. 28); nor may it simply accept Virginia's claim that because it adopted these policies it now has no revenue to pay the refunds. Rather, because these arguments are incapable of legal resolution, this Court cannot entertain them.

The Department of Taxation suggests that because it relied in good faith on a taxing scheme that had not been judicially challenged for almost half a century, it would be inequitable for it to have to refund some of the unconstitutional taxes it collected. Thus it faults petitioners for not having come forward sooner and saving it from its folly (and from collecting the billions of dollars of unconstitutional taxes imposed between 1942 and 1984). But petitioners' only duty was to pay their taxes, and, relying on Virginia's century-old refund statute, that they did. Virginia's legislators and executive officers had a different duty: to uphold and defend the Constitution of the United States. U.S. Const. Art. VI, cl. 3. Blaming their failure to fulfill this duty on petitioners is unjustified and undignified. More significantly, it provides no equitable justification for denying petitioners the refunds to which they are entitled.

For these reasons, petitioners submit that the Department of Taxation has no cognizable equitable claim to deny relief. Petitioners, many of whom are elderly and live on fixed incomes, are particularly incapable of bearing the unconstitutional burden the Department of Taxation has imposed upon them. As a matter of fundamental

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[25] To date, seven of the 23 states affected by *Davis*, Missouri, New Mexico, Michigan, Oregon, West Virginia, Louisiana and Colorado, which presumably faced similar choices, have paid refunds.

fairness, the Department of Taxation must refund petitioners' taxes.

IV. PETITIONERS ARE ENTITLED TO REFUNDS OF THE UNCONSTITUTIONAL TAXES THEY PAID ON THEIR FEDERAL PENSIONS

Perhaps in recognition of the infirmity of the lower court's choice of law holding, the Department of Taxation principally argues in its Brief in Opposition that petitioners are not entitled to relief even upon a retroactive application of *Davis*. Op. Cert. at 16-27. Thus, the Department of Taxation contends, even if *Davis* applies retroactively, "federal due process would not be violated by a restriction of relief to prospective invalidation of the tax." Op. Cert. at 18. This argument was explicitly rejected in *McKesson*:

> The question before us is whether prospective relief, by itself, exhausts the requirements of federal law. The answer is no . . .

496 U.S. at 31. Accordingly, the Department of Taxation's remedial argument is no more availing than its choice of law argument. If petitioners are not entitled to relief under state law, then they are entitled to relief under the Constitution. This Court should so hold.

The central premise of the Department of Taxation's argument on this score is Justice Souter's observation in *Beam* that "[n]othing we say here deprives respondent of his opportunity to . . . demonstrate reliance interests entitled to consideration in determining the nature of the remedy [to be] provided . . ." 111 S. Ct. at 2448. Contending that *McKesson* applies only in cases "where it was entirely foreseeable at the time of enactment" that the tax would be invalidated (which supposedly this tax was not), Op. Cert. at 16, the Department of Taxation argues that this Court may do by remedy what it cannot by choice of law: relegate petitioners to prospective-only relief.

This argument completely misconceives the command of this Court's tandem holdings in *McKesson* and *American Trucking Ass'ns*. Foremost, *McKesson* reaffirmed this Court's long-standing precedent that

> [b]ecause exaction of a tax constitutes a deprivation of property, the State must provide procedural safeguards against unlawful exactions in order to satisfy the commands of the Due Process Clause.

496 U.S. at 36. In recognition of states' interest in financial stability, this Court sanctioned a departure from the "root requirement" of due process that "an individual be given an opportunity for a hearing *before* he is deprived of any significant property interest." *Cleveland Board of Education v. Loudermill*, 470 U.S. 532, 542 (1985) (emphasis original). But this departure was only temporal:

> To satisfy the requirements of the Due Process Clause, . . . the State must provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligations, but also a "clear and certain remedy" for any erroneous or unlawful tax collection to ensure that the opportunity to contest the tax is a meaningful one.

496 U.S. at 39, *quoting Atchinson T. & S.F.R. Co. v. O'Connor*, 223 U.S. 280, 285 (1912). That is, in cases of unlawful taxation, the Constitution requires that taxpayers be afforded either a meaningful opportunity to prevent the imposition of the tax, or a post-deprivation remedy "designated to render the opportunity [to contest the tax] meaningful by preventing any permanent unlawful deprivation of property." 496 U.S. at 40.

The Department of Taxation contends that *McKesson's* requirement of an opportunity to "prevent[] any permanent unlawful deprivation of property" applies only "where it was entirely foreseeable" that the tax would be invalidated. Op. Cert. at 16. That is, it contends that

McKesson establishes the standard for "entirely foreseeable" invalidations of taxes, and *American Trucking Ass'ns* sets the standard for unforeseeable invalidations establishing "new principles of law." These cases, the Department of Taxation posits, stake out opposite ends of a continuum; in cases falling in between (presumably foreseeable but not entirely foreseeable invalidations of taxes), the constitutional entitlement to relief would similarly vary.[26]

In so arguing, the Department of Taxation misreads *McKesson* and *American Trucking Ass'ns*. These cases establish a binary choice: either the tax is unconstitutional, in which case "meaningful backward-looking relief" is required, *McKesson*, 496 U.S. at 31, or it is not, in which case due process is not implicated and prospective invalidation of the tax is sufficient. *American Trucking Ass'ns*, 496 U.S. at 181-82. As the Court held in *American Trucking Ass'ns*,

> Our decision today in *McKesson* makes clear that once a State's tax statute is held invalid . . ., the State is obligated to provide relief consistent with due process principles. When the State comes under such a constitutional obligation, equitable considerations play only the most limited role in delineating the scope of that relief.

496 U.S. at 181, citations omitted. *See also id.*, 496 U.S. at 184 ("As previously discussed, *McKesson* makes plain that equitable considerations are of limited significance once a constitutional violation is found.").[27]

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[26] Inexplicably, the Department of Taxation contends that the appropriate relief in a case that falls between establishing "a new principle of law" and being "entirely foreseeable" is the same relief required when, by reason of prospective decisionmaking, there is no constitutional deprivation: "restriction of relief to prospective invalidation of the tax." Op. Cert. at 18.

[27] *See also McKesson*, 496 U.S. at 31 n.15 (constitutional entitlement to relief arises when decision "rest[s] on established principles;" *i.e.*, there is no "new principle of law.").

Moreover, the sole "equitable consideration" the Department of Taxation presses is the cost of complying with its constitutional obligation to pay refunds. But the Court in *McKesson* dismissed the contention that the cost of refunds was a relevant consideration:

> We reject respondent's intimation that the cost of any refund considered by the State might justify a decision to withhold it. Just as a State may not object to an otherwise available remedy providing for the return of real property unlawfully taken or criminal fines unlawfully imposed simply because it finds the property or money useful, so also Florida cannot object to a refund just because it has other ideas about how to spend the funds.

496 U.S. at 51 n.35. *See also id.*, at 50 ("the State's interest in financial stability does not justify a refusal to provide relief.").

For these reasons, the Department of Taxation errs in reading *Beam*'s sanctioning of "reliance interests entitled to consideration in determining the nature of the relief *that must be provided*," 111 S.Ct. at 2448 (emphasis added), as allowing for less than full backward-looking relief. Rather, the "matter with which *McKesson* did not deal," *id.*, was the extent to which the state's interests "shap[ed] the contours of the relief that the State must provide to illegally or erroneously deprived taxpayers;" *i.e.*, the choice between full refunds, partial refunds and partial retroactive taxation of the favored class, and full retroactive taxation. *McKesson*, 496 U.S. at 50.

But this inquiry is irrelevant here as refunds are the only permissible remedy. Foremost, *McKesson* merely states the minimum relief constitutionally required: "[t]he State is free, of course, to provide broader relief as a matter of state law than is required by the federal Constitution." *McKesson*, 496 U.S. at 52 n.36. By adopting a tax refund statute, Virginia has done just that. Accordingly, even if the Constitution might permit some

form of retroactive taxation of the favored class in lieu of refunds, Virginia's statute does not. *See* Va. Code §§ 58.1-1820 - 58.1-1826. Moreover, because the discriminatory tax imposed here was beyond the statutory grant of immunity of 4 U.S.C. § 111, the tax "was beyond the State's power to impose" and accordingly Virginia would have "no choice but to 'undo' the unlawful deprivation by refunding the tax." *McKesson*, 496 U.S. at 39. *See also Moses Lake Homes, Inc. v. Grant County*, 365 U.S. at 752. Finally, while a different question might have been posed had Virginia immediately attempted to equalize the discrimination by retroactively taxing the favored class, any effort to do so now would plainly be so belated "as to transgress the constitutional limitation." *McKesson*, 496 U.S. at 40 n.23, *quoting Welch v. Henry*, 305 U.S. 134, 147 (1938).

For these reasons, petitioners submit that they are entitled to refunds of the taxes Virginia unconstitutionally imposed on their federal pensions. The court below held that Virginia's refund statute did not entitle petitioners to relief "because the *Davis* decision is not to be applied retroactively." Pet. App. at 15a.[28] Because *Davis* must be applied retroactively, however, Virginia's refund statute is controlling and petitioners are entitled to relief thereunder. Yet even if Virginia's statute did not accord petitioners this relief, they would be constitutionally entitled to "meaningful backward-looking relief," which, in this case, must mean refunds of the taxes unconstitutionally imposed on their federal pensions.

---

[28] The court below also held that under its own retroactivity jurisprudence petitioners were not entitled to relief. Pet. App. at 15a-16a. As noted in *American Trucking Ass'ns*, however, "[i]n order to ensure the uniform application of decisions construing constitutional requirements and to prevent States from denying or curtailing federally protected rights, we have consistently required that state courts adhere to our retroactivity decisions." 496 U.S. at 178. Accordingly, this basis for denying relief is untenable.

CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of Virginia denying petitioners refunds of taxes imposed on their federal pensions must be reversed with instructions to grant petitioners' refunds.

Respectfully submitted,

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October Term, 1992

HENRY HARPER, et al.,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

On Writ Of Certiorari To
The Supreme Court Of Virginia

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QUESTION PRESENTED

Whether federal law compels the Virginia Supreme Court to interpret its tax refund statute in such a way as to require refunds to Petitioners for taxes paid prior to this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989).

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STATEMENT OF THE CASE

On the day *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989) ("*Davis*"), was decided, Virginia law contained what had been thought for almost 50 years to be a fair and reasonable provision excluding from taxable income retirement benefits paid by the State to its former employees. Va. Code § 58.1-322(C)(3) (1950); *see* Ch. 325, 1942 Va. Acts 481, 500 (Reg. Sess.). The exclusion was adopted as an alternative to (and what was thought the functional equivalent of) additional retirement compensation to the State's former employees. It was not challenged by anyone, including the taxpayers now before this Court, during the nearly half century between its adoption and the decision in *Davis*.

Davis held that this type of tax violated federal law. At least 23 states had similar statutes, well over half of the 41 that have a personal income tax. All states moved to conform their laws to the newly-stated *Davis* requirements. In Virginia, then-Governor Baliles called a Special Session of the legislature within weeks of the decision. The specific exemption for state and local government retirement income was repealed, effective for taxable years beginning on or after January 1, 1989, and a system of taxation for pensioners' income indisputably acceptable under *Davis* was enacted in its stead.

Following the corrective action by the Virginia legislature, Petitioners filed suits in state court against the Virginia Department of Taxation (hereafter "Commonwealth"), seeking refunds for state income taxes paid on their federal retirement income for the pre-*Davis* taxable years of 1985, 1986, 1987, and 1988. The estimated potential refund liability Virginia faces for the still viable claims of its approximately 200,000 federal retirees – not all of whom are parties to the present lawsuit – is over $467 million. This is the equivalent of the income that would be produced in one year from a 22% increase (from 4.5% to 5.5%) in Virginia's sales tax or, alternatively, a 13.6% surcharge on the 1991 income tax bill of every individual taxpayer. It is more than the entire annual

budget for Virginia's Department of Corrections or, alternatively, more than the annual state general fund appropriation for Virginia's three largest state Universities. The estimated total refund liability of all states with pending *Davis*-based litigation is more than $1.8 billion. (*See* Supplemental Appendices to this Brief ("SA") at SA 1-3.)

Petitioners base their claim for relief on Va. Code § 58.1-1826 (1991), which provides that the state courts "may" order refunds "[i]f the court is satisfied that the applicant is erroneously or improperly assessed with any taxes." As elaborated below, this language has been interpreted by the Virginia Supreme Court – in cases that arose long before *Davis* and its resulting litigation – not to mandate refunds when a tax is unexpectedly overturned as unconstitutional. As also elaborated below, a pre-payment remedy was available to these taxpayers (had they thought to object to the taxes before *Davis* and before the taxes were paid) by application to the State Tax Commissioner.

The state trial court denied Petitioners' refund claims. In *Harper v. Virginia Department of Taxation*, 241 Va. 232, 401 S.E.2d 868 (1991) ("*Harper I*"), the Virginia Supreme Court affirmed on two independent grounds, one based on federal law and one based on state law. The federal ground was that *Davis* need not be applied retroactively and, thus, does not provide the basis for refund liability. The state law ground, based on pre-*Davis* precedent discussed below, was that the state remedy provided in § 58.1-1826 is not available on the facts presented. No challenge to this state ground of decision was made by Petitioners in their petitions for certiorari.

Petitioners sought certiorari in this Court from *Harper I*. After its decision in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991) ("*Beam*"), this Court granted certiorari in *Harper I* and vacated and remanded for further consideration in light of *Beam*. The Virginia Supreme Court held that *Beam* did not require a different result and reaffirmed its former decision "in all respects." *Harper v. Virginia Department of Taxation*, 242 Va. 322, 327, 410 S.E.2d 629, 632

(1991) ("*Harper II*"). This Court granted the present writ of certiorari following the decision in *Harper II*. (For the convenience of the Court, both *Harper I* and *Harper II* are reproduced in Appendix B to this Brief, SA 4-19.)

SUMMARY OF ARGUMENT

In order to prevail on their refund claim, Petitioners must establish two independent propositions. The first is that the pre-*Davis* tax violated a federal right. The Virginia Supreme Court held that no federal rights were violated because *Davis* need not be applied retroactively to taxable years that were completed before *Davis* was decided. The second is that the state remedy sought by Petitioners is available to them. The Virginia Supreme Court held that the state remedy invoked by Petitioners is not available whether or not *Davis* is to be applied retroactively. Prior decisions of this Court establish that questions of remedy in this context are controlled by state law, subject to the normal requirements that the state law ground for decision be "adequate" and "independent." These requirements are satisfied here.

At bottom, the Commonwealth's argument is that, at some point in the analysis, federal law permits equitable considerations to control the availability of refund relief in the present context and that such considerations overwhelmingly support the conclusion that refunds of pre-*Davis* taxes are not necessary to accomplish the objectives of federal law in this sphere.

The first opportunity to take equitable considerations into account is in determining whether the principles of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) ("*Chevron Oil*"), are to control whether *Davis* must be applied retroactively. The Commonwealth's argument in this respect is that the *Chevron Oil* formula should be applied to the present case, and that its application is not foreclosed by this Court's decision in *Beam*. *Davis* established a "new" principle of law as that term is used in *Chevron Oil*, and the remainder of the *Chevron Oil*

principles establish that it would be inappropriate to apply *Davis* retroactively.

The second opportunity to take equitable considerations into account – even if *Davis* is to be applied retroactively – is in determining whether the Commonwealth is obligated to provide to Petitioners the particular state remedy they sought below. The Virginia Supreme Court held that this remedy was unavailable for reasons well-established in prior state law. There are two reasons why this conclusion is unassailable. The first is that prospective relief is a sufficient remedy under applicable federal due process principles. The second is that federal due process principles do not in any event require a post-payment refund remedy in situations where a pre-payment remedy was available to the taxpayer.

ARGUMENT

THE SUPREME COURT OF VIRGINIA PROPERLY HELD THAT PETITIONERS ARE NOT DUE REFUNDS FOR STATE TAXES ASSESSED ON THEIR FEDERAL RETIREMENT INCOME PRIOR TO THE DECISION IN *DAVIS*.

I. Application of the *Chevron Oil* formula leads to the conclusion that *Davis* does not apply to taxable years concluded before that decision.

A. This Court's decision in *Beam* does not preclude the application of *Chevron Oil* to the *Davis* decision.

An argument made by the Petitioners must be set aside at the outset. The conflicting rationales underlying this Court's decision in *Beam* support the conclusion that "selective prospectivity" is no longer an option. That is, it would not be appropriate for federal law to dictate the application of *Davis* retrospectively to the litigant before the Court in *Davis* but not to Petitioners. Petitioners seize upon this point to argue that since the Court applied the holding in *Davis* to its parties, it must now do so here. Petitioners' Brief ("Pet. Br.") at 3-4, 6-10.

This argument, of course, begs the central question whether the Court did in fact apply its *Davis* holding retrospectively to the litigant before the Court in *Davis*. A careful examination of the question begged by the Petitioners' argument shows that, as the Virginia Supreme Court twice found,[1] this Court did not resolve the federal issue of retroactivity in *Davis*. Neither did it in *Barker v. Kansas*, 112 S. Ct. 1619 (1992).

In the first place, the question whether federal law commanded retroactivity was not contested in *Davis*, nor even mentioned by the parties, by the amici, by the Court, or by the dissent. What the Court said, after concluding that the tax at issue in *Davis* violated principles of intergovernmental tax immunity, was: "The State having conceded that a refund is appropriate in these circumstances, see Brief for Appellee 63, to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." *Davis*, 489 U.S. at 817. This is all the Court said. Yet Petitioners argue that this one sentence resolves an issue that was not before the Court, that was not considered or discussed by parties or by the Court, and that creates a potential liability of more than $1.8 billion to be imposed on innocent taxpayers in 23 states.

This simply cannot be true. This Court does not conduct its affairs in such cavalier fashion. Courts do not act reflexively or arbitrarily. It would be unconscionable for this Court to resolve an issue of such importance to so many taxpaying citizens of so many states without the benefit of any briefing, argument, thought, analysis, or consideration. This Court simply does not – and, of equal importance, cannot be perceived to – work in a manner that is so fundamentally at odds with the principles of fair play underlying the concept of due process of law. Whatever the right outcome of this case, the answer cannot be that there are no issues to be argued because

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[1] On remand, the Virginia Supreme Court reiterated its earlier determination (*Harper I*, 241 Va. at 235 n. 1, 401 S.E. 2d at 870 n.1) (SA 5), that "the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated." *Harper II*, 242 Va. at 322, 410 S.E. 2d at 632. (SA 18).

the Court has previously resolved them without any evidence of having given the matter any thought or attention and without giving any affected parties the opportunity to be heard. This argument by Petitioners must be rejected.

Petitioners also, it can be added, misinterpret the stipulation made by Michigan in *Davis*. It is well established in the decisions of this Court – the point was clearly made in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 52 n.36 (1990) ("*McKesson*") – that states are free to provide remedies that exceed the requirements of federal law. The fact that Michigan volunteered to supply Davis with a remedy for prior tax years does not mean that this Court addressed any issues with regard to federal requirements of retrospectivity. It is also well-established that this Court does not make gratuitous decisions, that it does not resolve important questions of federal law in advance of the necessity of resolving them. It is well within this tradition to regard the Court's one-sentence treatment of Michigan's concession in *Davis* as taking Michigan up on its volunteered remedy without passing on the question whether federal law required the payment of refunds to Mr. Davis.[2] In short, *Davis* can be "fairly read" *not* "to hold as a choice of law that its rule should apply retroactively to the litigants then before the Court." *Beam*, 111 S. Ct. at 2445.[3] While *Beam* rejected the

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[2] That this Court is not in the habit of resolving important questions without thought or consideration is also evident from its invitation last Term for amicus curiae briefs on the issue of retroactivity in the reargument of *Allied-Signal, Inc. v. Director, Div. of Taxation*, 112 S. Ct. 2251 (1992) ("*Allied-Signal*") (eight amicus curiae briefs were filed in *Allied-Signal* presenting arguments to the Court on the retroactivity issue; the Court did not reach the retroactivity question since it rejected the claim that would have raised it).

[3] Petitioners and some of the amici argue that *Davis* must have decided the retroactivity issue as a matter of federal law because, they say, *Beam* establishes that the question is always decided if not explicitly reserved. E.g., Pet. Br. at 10. They rely in making this argument on one sentence in *Beam* in a discussion the focus of which was not on whether an explicit reservation was a *sine qua non* of non-retroactivity. Essentially, the Court said that in context it made sense to read *Bacchus Imports, Ltd v. Dias*, 468 U.S. 264 (1984) ("*Bacchus*") as applying the rule of that case to the parties before the Court. There is no evidence on the face of the

option of "selective prospectivity," it clearly did not overrule *Chevron Oil*, and it expressly left open the possibility that "pure prospectivity" might apply in the *Davis* context. It is to this possibility that the Commonwealth now turns.

B. The *Chevron Oil* formula is fair and workable and should be preserved as the test for the retroactivity of new principles of law.

Constitutional doctrines do not always develop to the point that precedent predicts or even clearly hints at the result the Court ultimately reaches. *Chevron Oil* recognizes that the Supreme Court not only overrules precedent but also reaches results that are not ordained by prior law. Reference to the legal and factual landscape composing a body of law may fail to predict the course taken by the Court in a particular case.[4] When this occurs in a tax case, the burden of a rule of law that is "new" in this sense may fall on either the government or the taxpayer. Full retroactive application of the "new" rule could result in a refund of already budgeted resources or in the collection of unanticipated back taxes. *Chevron Oil* provides a method for accommodating unforeseen changes in the law without destroying reliance interests and settled expectations. It complements principles of *stare decisis* by

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Beam opinion that this Court meant to establish formal reservation as a litmus test. Even if it did, that itself would be the adoption of a "new" rule that could not fairly be applied to decisions, such as *Davis*, that were decided before *Beam*. The jurisprudential climate at the time *Davis* was decided does not support the conclusion that the Court's one-sentence acceptance of the Michigan concession was meant to resolve, or would have been fairly understood by the legal community at the time as necessarily resolving, retroactivity issues involving claims of states and individuals not parties to that suit.

[4] Unlike the interstate commerce clause, the intergovernmental tax immunity doctrine is infrequently the basis for a constitutional challenge to a state tax. The body of law in this area is thus scant, and the doctrine has been referred to as "a most esoteric of constitutional philosophies." *Bohn v. Waddell*, 164 Ariz. 74, 86, 790 P.2d 772, 784 (Tax Ct. 1990). *See also Swanson v. Powers*, 937 F.2d. 965, 968 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 871 (1992) (doctrine of intergovernmental tax immunity "at best, ambiguous").

recognizing the values of stability and foreseeability in the law.[5]

Chevron Oil has proved to be a sound and workable rule of judicial decision-making. Appropriately, it has been employed only in rare circumstances where the impact of a "new" ruling would be especially burdensome to the justifiable reliance interests of one party or another. Even prior to *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990) ("*ATA v. Smith*") and *Beam*, state courts had applied the equitable principles enunciated in *Chevron Oil* to determine the retroactivity of both state and United States Supreme Court decisions. These courts have found *Chevron Oil* to provide a workable solution to the retroactivity problem and have applied its test in a reasonable and responsible manner. *Compare American Trucking Ass'ns v. Conway*, 152 Vt. 383, 566 A.2d 1335 (1989) (Supreme Court decision retroactive under *Chevron Oil* because predicted by state case), *with Opinion of Justices*, 131 N.H. 644, 557 A.2d 1364 (1989) (state court decision not retroactive because it upset tax practice relied on by taxpayers and by state).[6] This Court too

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[5] This Court has consistently, and recently, acknowledged the importance of reliance interests when it is called upon to make changes in the law. In *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), the Court refrained from overruling *National Bellas Hess Inc. v. Department of Revenue*, 386 U.S. 753 (1967), stating: "The interest in stability and the orderly development of the law that undergirds the doctrine of *stare decisis* . . . counsels adherence to settled precedent." 112 S. Ct. at 1916 (1992). But not every issue presented to the Court is resolved by "adherence to settled precedent." It is in such a case that, by limiting the backward reach of the new decision so as not to upset settled expectations, the approach of *Chevron Oil* achieves the same purpose as the doctrine of *stare decisis:* protection of the "interest in stability and the orderly development of the law."

[6] Other state courts besides New Hampshire's and Vermont's have found the *Chevron Oil* test an appropriate judicial tool for determining retroactivity. *See Private Truck Council, Inc. v. State*, 111 N.J. 214, 544 A.2d 33 (1988) (state's retaliatory truck tax violates Commerce Clause; state's prospectivity argument rejected without comment); *National Can Corp. v. Department of Revenue*, 109 Wash. 2d 878, 749 P.2d 1286, *cert. denied*, 486 U.S. 1040 (1988) (Supreme Court decision that invalidated tax repeatedly upheld by state court not retroactive; state justified in relying on earlier decisions); *Exxon Corp v. Hunt*, 109 N.J. 110, 534 A.2d 1 (1987) (Supreme Court decision retroactive because did not establish new

has found it appropriate to temper the burden of "new" rules by the adoption of limitations on the retroactive reach of its decisions. *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982); *Buckley v. Valeo*, 424 U.S. 1 (1976); *Hill v. Stone*, 421 U.S. 289 (1975); *Lemon v. Kurtzman*, 411 U.S. 192 (1973); *Phoenix v. Kolodziejski*, 399 U.S. 204 (1970); *Cipriano v. City of Houma*, 395 U.S. 701 (1969); *Allen v. State Bd. of Elections*, 393 U.S. 544 (1969); *England v. Louisiana State Bd. of Medical Examiners*, 375 U.S. 411 (1964); *cf. Teague v. Lane*, 489 U.S. 288 (1989), and its progeny.[7]

Chevron Oil does not require the Court to reject the traditional rule that judicial decisions are in general retroactive. But it allows the Court, in the extraordinary case, to temper the harshness of a strict rule of retroactivity. Use of the *Chevron Oil* approach is particularly appropriate in areas where a single decision of this Court introduces a far-reaching change in the law that imposes a dramatic new liability that was not foreseeable based on settled understandings that had accumulated over the years.[8]

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rule of law under *Chevron Oil*); *First of McAlester Corp. v. Oklahoma Tax Comm'n*, 709 P.2d 1026 (Okla. 1985) (Supreme Court decision invalidating tax on interest income not retroactive because of lack of foreseeability); *Salorio v. Glaser*, 93 N.J. 447, 461 A.2d 1100, *cert. denied*, 464 U.S. 993 (1983) (decision not retroactive based on justifiable reliance on long-standing unchallenged statute).

[7] The Commonwealth recognizes that there is debate on the Court as to whether these decisions stem from choice-of-law or remedial principles. *See, e.g., Beam*, 111 S. Ct. at 2443-44. The important point underlying the Commonwealth's position in this case is that the principles recognized in *Chevron Oil* be considered at some point in the analysis, that recognition be given at the end of the day to justifiable reliance interests and settled expectations. Whatever the theory, the Commonwealth does not understand the debate to question the correctness of the *results* in the cited cases. Just as in those cases, there are strong equitable considerations that should lead to a similar result in this case.

[8] These values are of importance both to the states as tax collectors and to taxpayers. As Allied-Signal, Inc. stated to this Court in April 1992:

> There is one proposition that both parties and all of the *amici* that address the question accept: that the test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), should determine whether a decision overruling *ASARCO* and *Woolworth* is retroactive. This unanimity on the part of

Davis is that extraordinary case that imposes such a dramatic new liability. The decision of this Court three years ago in *Davis* generated litigation involving more than $1.8 billion in refund claims in at least 23 states.[9] Much of this litigation has yet to be resolved in the state courts, and five cases that originated in state courts are presently pending in this Court on petitions for certiorari.

In Virginia alone, the potential refund liability resulting from the *Davis* decision now exceeds $467 million. Joint Appendix ("JA") 24 . This Court can take judicial notice that this sum is larger than the entire annual budget for the Department of Corrections. It is also larger than the annual general fund appropriation for the three largest universities in the State. SA 2. Revenue losses to the State due to inflation, the condition of the economy, and an 18.4% increase in federally mandated Medicaid expenses have already required the reduction of state agency budgets on an average of 25% below 1990 funding levels, as well as the elimination of jobs through early retirement and layoffs. The losses that would

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> taxpayers and taxing officials – even those whose short-term interests in this case might be furthered by a rule of absolute retroactivity – is a powerful reminder that stability in the law is highly valued by all segments of society.

Reply Brief of Petitioner on Reargument at 15-16.

Likewise, the Tax Executives Institute (representing taxpayer interests) embraced the *Chevron Oil* test in its *Allied-Signal* amicus brief, and further argued at 17:

> The retroactive [application of a new rule] would also send an ominous signal to all taxpayers concerning their ability to rely on established rules. Not only would multijurisdictional taxpayers be exposed to unexpected and potentially enormous tax liabilities for all open tax years, but they would be deprived of the certainty necessary to conduct their business affairs in an orderly manner.

Chevron Oil provides a standard for protecting reliance interests and the orderly conduct of business in a manner that is equitable both to taxpayers and to states.

[9] Alabama, Arizona, Arkansas, Colorado, Georgia, Iowa, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, New Mexico, New York, North Carolina, Oklahoma, Oregon, South Carolina, Utah, Virginia, West Virginia, and Wisconsin. *See* W. Hellerstein, *Preliminary Reflections on* McKesson *and* American Trucking Associations, 48 Tax Notes 325, 326 (1990).

result from the application of *Davis* to require refunds to these Petitioners and other similarly situated federal retirees can be recouped only by making further cuts in services or employment, or by enacting additional revenue measures. The amount of additional revenue required to offset this unexpected liability, should it materialize, is the equivalent of the income that would be realized in one year from a 22% increase in Virginia's sales tax from 4.5% to 5.5% or by imposing a 13.6% income tax surcharge on the 1991 returns of all citizens in the State. Surely there is room in legal doctrine to make the consideration of factors such as these relevant to the potential retroactive imposition of monetary liability for a newly announced principle of law.

C. Application of the *Chevron Oil* formula to *Davis* results in the conclusion that *Davis* should not be retroactively applied.

1. *Davis* established a new principle of law.

The first issue in the application of *Chevron Oil* to these facts is whether *Davis* announced a "new" rule of law. Expressed in the language of *Chevron Oil* itself, the question is whether *Davis* decided "an issue of first impression whose resolution was not clearly foreshadowed."[10] *Chevron Oil*, 404

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[10] Petitioners attempt arbitrarily to limit *Chevron Oil* to cases in which new law is established by the overruling of prior Supreme Court precedent. But this is inconsistent with the language of *Chevron Oil* itself, which explicitly described a "new principle of law" as one which "overrul[ed] clear past precedent on which litigants may have relied" *or* "decid[ed] an issue of first impression whose resolution was not clearly foreshadowed." *Chevron Oil*, 404 U.S. at 106. Indeed, *Chevron Oil* itself declined to apply retrospectively a decision that overruled no prior Supreme Court precedent. Moreover, as *Chevron Oil* itself recognizes, the effect on reliance interests and settled expectations can be the same when the Court decides an issue of first impression as when it overrules past precedent. This Court is unlikely ever to see a stronger case of reliance and settled expectations than here presented.

Petitioners also construct an argument, not presented in the court below, that *Chevron Oil* cannot apply in a case involving a federal statute. Unless *Davis* is fully retroactive, Petitioners assert, this Court will be usurping a legislative power by

U.S. at 106. Expressed in the related language of the principles undergirding *stare decisis*, the question is whether *Davis* upset "substantial reliance and expectations that had become part of a basic framework" of a state's authority to impose taxes. *Quill Corp.*, 112 S. Ct. at 1916.

(i) If *Davis* did not announce a new principle of law, why did Petitioners and other taxpayers like them pay the tax for nearly half a century without mounting any legal challenge?

This Court has observed that when a decision "disrupts a practice long accepted and widely relied upon,"[11] it constitutes a new rule of law. At the time of the *Davis* decision, a majority of the states that impose an earned income tax (23 out of 41) had statutes similar to the Michigan statute at issue in *Davis*. Many of these statutes, including Virginia's, had been in effect for nearly half a century. *See* Ch. 325, 1942 Va. Acts 500. Section 111 of Title 4 of the United States Code, on which so much reliance is placed by Petitioners, was enacted in 1939. Public Salary Tax Act of 1939, ch. 59, § 4, 53 Stat. 575, now codified at 4 U.S.C. § 111. The intergovernmental tax immunity doctrine had been around much longer. Yet federal pensioners living in these 23 states and their tax lawyers evidently found nothing in the language of § 111 or prior Court decisions which "foreshadowed" *Davis* sufficiently to provoke litigation. Before *Davis*, not one Virginia pensioner (including retired Internal Revenue Service officials and retired federal tax lawyers) sought through either judicial or administrative proceedings to have the tax declared

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determining the effective date of an Act of Congress. This argument is contrary to prior decisions of this Court, including *Chevron* itself which delayed the effect of a *federal* statute, 43 U.S.C. § 133(a)(2), which incorporated state statutes of limitations. *See also Florida v. Long*, 487 U.S. 223 (1988); *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982).

[11] *Milton v. Wainwright*, 407 U.S. 371, 381-82 n.2 (1972) (Stewart, J., dissenting), *quoted with approval* in *United States v. Johnson*, 457 U.S. 537, 552 (1982).

unconstitutional as violating § 111 or intergovernmental tax immunity.[12] What Petitioners portray as the application of settled law to an unambiguous statute was, in fact, entirely unpredicted for almost 50 years by 23 legislatures and by hundreds of thousands of taxpayers whose self-interest would have led them to object had they thought the tax problematical. The fact that this widespread tax policy had gone unchallenged for so many years, by either the United States or hundreds of thousands of federal retirees living in these 23 states, itself is compelling – indeed conclusive – evidence that *Davis* announced a new rule of law.

(ii) The only federal court to consider the issue held *Davis* not foreseeable.

Only one federal court has had the opportunity to address the foreseeability of *Davis*. *Swanson v. Powers*, 937 F.2d 965 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 871 (1992) ("*Swanson*"). *Swanson* was a civil action filed under 42 U.S.C. § 1983 against the North Carolina Secretary of Revenue exposing her to a potential personal liability of $140 million for enforcing the North Carolina counterpart to the tax invalidated in *Davis*. In an opinion by Judge J. Harvie Wilkinson, the Fourth Circuit held Ms. Powers entitled to the defense of qualified immunity on the ground that the principles upon which *Davis* was based were "not clearly established at the time." 937 F.2d at 966. The plaintiffs argued in *Swanson*, as Petitioners argue here, that nothing "new" was established in *Davis*. Speaking for the court, Judge Wilkinson responded:

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[12] Until *Davis*, federal retirees in Virginia confined their objections to this tax to appeals to the political process. *See* Report of House Finance Retirement Subcommittee, Dec. 1982, cited in Brief Amicus Curiae on Behalf of Military Coalition in Support of Petitioners. There are no facts in the record nor any known to the Commonwealth which suggest that prior to *Davis*, the Virginia tax benefit to state retirees had been challenged as illegal (under § 111 or any other theory). Even in the legislative study focused on this particular tax there is no argument that the tax violated any law. It should be emphasized that the federal retirees were unsuccessful in persuading the legislature to change its tax policy, and they *still* made no effort to challenge the tax in a judicial or administrative forum until after this Court's decision in *Davis*.

> We disagree. Secretary Powers was enforcing a long-standing statute that was similar to enactments elsewhere. The most pertinent judicial decisions had upheld comparable taxing schemes and the doctrine of intergovernmental immunity was, at best, ambiguous. We decline to proclaim in hindsight after the *Davis* decision, that the unconstitutionality of differential tax exemptions had been clear all along.

937 F.2d at 968.

It is against the background of other "pertinent judicial decisions" that the Fourth Circuit reviewed *Davis*. In response to the argument – repeated here by Petitioners – that the doctrine of intergovernmental tax immunity is long-standing, hailing from the time of *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819), Judge Wilkinson correctly observed that "the vintage of the asserted right is of less guidance than the specificity of the right." 937 F.2d at 969. Judge Wilkinson noted that, prior to *Davis*, no court had struck down tax exemptions similar to the one challenged in *Davis*. In fact, the only two state courts that had considered the exemption had upheld the statutes. *Davis v. Michigan Dep't of Treasury*, 160 Mich. App. 98, 408 N.W.2d 433 (1987); *Streight v. Ragland*, 280 Ark. 206, 655 S.W.2d 459 (1983).

The Fourth Circuit also reviewed a line of federal cases that establish the "modern approach to intergovernmental tax immunity." *See United States v. County of Fresno*, 429 U.S. 452 (1977); *United States v. City of Detroit*, 355 U.S. 466 (1958); *James v. Dravo Contracting Co.*, 302 U.S. 134 (1937). The court rejected the argument that these cases formed a basis for predicting that the tax exemption was unconstitutional. In fact, the court concluded, the cases viewed as a whole represent the Court's "shift in emphasis away from immunity from taxation and toward limitation of such immunity." 937 F.2d at 970. Narrowing its review finally to recent intergovernmental tax immunity decisions more specifically related to the facts in *Davis*, the court concluded that the rationale of these cases could reasonably lead to a

contrary result from that reached in *Davis*. *See South Carolina v. Baker*, 485 U.S. 505 (1988); *Washington v. United States*, 460 U.S. 536 (1983); *United States v. County of Fresno*, 429 U.S. 452 (1977). These cases were based on the rationale that states could not impose an unfair burden on the federal government by "singling out" federal interests for different treatment. In *Davis*, the tax was imposed not only on federal retirees but also on all private retirees, thus singling out retired state employees for an exemption but not singling out retired federal employees for a tax. *Swanson*, 937 F.2d at 970. It was this divergence in *Davis* from the rationale supporting other intergovernmental tax immunity doctrine decisions that the Fourth Circuit regarded as an important basis for its holding that *Davis* had not been "clear all along."[13]

(iii) *Davis* decided two issues of first impression whose resolution was not clearly foreshadowed by prior decisions.

We address in this section of the brief two of the fundamental respects in which *Davis* announced new principles of law. We do so not to reargue the merits of that decision, but to highlight the ways in which, in the language of *Chevron Oil*, the result reached was not clearly foreshadowed by prior decisions.

All tax classifications, of course, "discriminate" among groups and types of income. In general, as this Court noted in *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376, 385 (1960) ("*Phillips Chemical*"), the state has

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[13] There is a difference between the issue in the present litigation and the issue in *Swanson*. Yet the cases governing when a qualified immunity can be asserted in a § 1983 suit have as one of their primary goals the avoidance of unfairly imposing retroactive monetary liability on state officials for failing to foresee the unforeseeable. The issue here is the same, albeit here the defendant is the state (or more realistically its taxpayers). The unconscionability of holding Ms. Powers personally liable for $140 million for failing to anticipate *Davis* strongly suggests that the general public should not suffer decreased public safety or education (or, conversely pay more taxes) in order to pay a retroactive damage award for the failure of the same public officials to foresee the unforeseeable.

broad discretion to make distinctions and classifications as long as there is a nonarbitrary, rational basis for what has been done: "[T]he State's power to classify is, indeed, extremely broad, and its discretion is limited only by constitutional rights and by the doctrine that a classification may not be palpably arbitrary." What Virginia and other states did not foresee, and had no reason to foresee, is that the tax exemption at issue in *Davis* constituted a discrimination against *federal government interests* and therefore implicated § 111 and the intergovernmental tax immunity doctrine. Below we show why this was so.

(1) *The Interpretation of Section 111.* The meaning of the Public Salary Tax Act of 1939, 4 U.S.C. § 111, had never been addressed by this Court prior to *Davis*. In that decision it was read for the first time as applying to former federal employees who were receiving retirement benefits.

Section 111 provides, in relevant part:

> The United States consents to the taxation of the pay or compensation for personal service as an officer or employee of the United States . . . by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of the pay or compensation.

The Michigan Supreme Court held this statute inapplicable to Mr. Davis because he was not then an employee of the United States and his retirement income accordingly was not compensation for services "as an . . . employee." This Court disagreed. While conceding that "Congress could perhaps have used more precise language," 489 U.S. at 810, and acknowledging that retirees are no longer "employees," this Court concluded that the pensions of federal retirees constituted compensation they received "as" federal employees with payment deferred until retirement.

As the Fourth Circuit concluded in *Swanson*, this reading was not clearly foreshadowed by prior decisions. The *Swanson* court, noting that "federal law often draws distinctions

between employees and retirees,"[14] concluded that "how the intergovernmental tax immunity doctrine and 4 U.S.C. § 111 applied to North Carolina's revenue statutes was *anything but* clearly established prior to *Davis*." 937 F.2d at 971 (emphasis added).

The only cases cited by this Court in support of its reading of § 111 were three federal circuit court opinions: *Zucker v. United States*, 758 F.2d 637 (Fed. Cir.), *cert. denied*, 474 U.S. 842 (1985); *Kizas v. Webster*, 707 F.2d 524 (D.C. Cir. 1983); and *Clark v. United States*, 691 F.2d 837 (7th Cir. 1982). It would have taken a truly heroic effort to read these three cases as presaging the conclusion reached by this Court in *Davis*.[15]

If anything, *Clark* suggests that the *Davis* tax was entirely appropriate. *Clark* rejected a claim by state and private pensioners who argued that they were being discriminated against when Congress provided a cost-of-living adjustment to federal pensioners but not to them. The court held that federal pensioners constituted a legitimate class of similarly situated persons (distinct from state and private pensioners) to whom "[t]he United States . . . has special responsibilities and obligations . . . that it does not have to non-federal employees." 691 F.2d at 841-42. Such special

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[14] The Court's illustrations of this point were *Allied Chemical Co. & Alkali Workers v. Pittsburgh Plate Glass Co.*, 404 U.S. 157, 165-71 (1971) ("employee" as used in National Labor Relations Act does not include "retirees"); *Ernzen v. United States*, 715 F.Supp. 1483, 1485 (S.D. Cal. 1989) ("[n]owhere does the [tax] code define 'retirees' as 'employees'"); 26 U.S.C. § 61(a)(1), (11) (Internal Revenue Code distinguishing between "compensation for services" and "pensions").

[15] The issue in *Zucker* was entirely unrelated to the issues in *Davis*. It was *argued* (for another purpose, under other statutory provisions) that federal retirement benefits were a form of deferred compensation, but the court explicitly did "not reach the question of the compensatory nature of the basic annuity to which the retiree became entitled upon retirement." 758 F.2d at 639. *Kizas* did not even involve federal retirees. It was a suit by clerical and support personnel of the FBI objecting to an affirmative action program adopted by the Bureau and to resulting changes in the "special preferences" under which they could make application to become Special Agents. *Clark* did discuss the pension benefits of federal employees, but it did not do so in the context of whether retirees received their benefits "as" employees under § 111.

treatment of federal retirees allowed the federal government to "compete with the private sector by offering federal employees an attractive retirement plan." *Id.* at 842. And the court said explicitly that "[a]ttracting and retaining qualified employees is a legitimate state objective that is rationally achieved by a retirement plan offering an economic inducement . . . ." *Id.* This rationale would appear fully to support the Michigan court's conclusions that Michigan was justified in making a tax distinction that benefitted its own pensioners.[16]

This Court's reading of § 111 may, in retrospect, seem perfectly logical, but the fact remains that from the enactment of the statute in 1939 until the decision in *Davis* 50 years later there were no decisions – by this Court or any other federal or state court – that had addressed the issue resolved in *Davis* or, indeed, any closely analogous issue from which the result in *Davis* could have been predicted.[17] The Virginia statute that was displaced by Davis was enacted in 1942, only three years after § 111 was enacted. To say now that the *Davis* interpretation of § 111 had so obviously been the law since 1939 that the Virginia legislature should have revised its tax policies for the years at issue in this case, even though no state, no taxpayer, and no court had occasion to recognize that fact during the preceding 45 years of the existence of the tax, would seem so plainly wrong as not to warrant comment were it not the heart of Petitioners' argument in this case.

(2) *Whether the tax discriminated against federal interests.* The determination that § 111 applied to the tax before the Court in *Davis* was only the first step in the analysis. Section 111 by its terms consents to the taxation of federal

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[16] There was surely nothing in *Clark* to suggest that an enhancement in the form of a cost-of-living increase was materially different from an enhancement in the form of a tax benefit. Nor was there anything to suggest that *Clark* was addressing a special privilege of the federal government that would not be equally available to the states.

[17] Prior to *Davis* there were only a handful of reported cases interpreting § 111, none of which forecasted the result in *Davis*. Most involved the question whether the consent to tax extended to territories and municipalities.

employees so long as the taxes do not "discriminate against the . . . employee because of the source of the pay or compensation." The critical question in *Davis*, therefore, was whether the Michigan tax worked such a discrimination. And this question, the Court held in *Davis*, was to be measured against the doctrine of intergovernmental tax immunity.

There are three steps in the resolution of any claim of unwarranted discrimination, whether it be under the equal protection clause or some other constitutional or statutory limitation. The first is to identify who it is that is being discriminated against and on what basis. The second is to determine the level of protection against discrimination to which that party is entitled, to choose the standard against which justifications for the discrimination are to be measured. The third is to assess any offered justifications for the discrimination against the chosen standard.

It is the first of these steps that was crucial in *Davis*. There were two ways to look at the classification adopted by the *Davis* tax that would have been relatively benign. One would have been to regard the state and local pensioners as being preferred to all other taxpayers in the state or, to turn the point around, to regard the tax benefit as discriminatory against all other taxpayers as an undifferentiated group.[18] Another (as in *Clark*) would have been to regard those who were receiving pensions from state or local government as being preferred to all other taxpayers who were receiving pensions (*i.e.*, those who were receiving pensions from the federal government and those who were receiving pensions from private sources).[19] In this case, the group that was being discriminated against would be federal pensioners and private pensioners as an undifferentiated group. Had the distinction drawn

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[18] In Michigan, there were 4½ million individual taxpayers and 130,000 retired state employees. If this were the proper frame of reference, the question would be whether some 24,000 federal retirees were being discriminated against by being grouped with the 4½ million rather than the 130,000.

[19] This would have been in accord with one of the prime rationales stated for § 111: the fairness of "subject[ing] the compensation of public officials and employees to the same general burden of taxation as is borne by *private employees*." S.Rep. 112 at 1, 76th Cong., 1st Sess. (1939) (emphasis added).

by the *Davis* statute been viewed in either of these manners, the conclusion easily could have been reached that there was no discrimination against the federal government or its employees. Former state employees were being favored, to be sure, but they were a small group being preferred to much larger classes of persons that included federal retirees but that also included many other taxpayers unconnected with the federal government.[20] It most likely would have followed, were this the proper perspective, that the tax in *Davis* would have been upheld.[21]

The Court's reasoning in *Davis* did not follow this path. Its premise was that the tax should be regarded as preferring those who were receiving pensions from the state to those who were receiving pensions from the federal government or, again to turn the point around, to regard the tax as discriminatory against federal interests. Once the distinction drawn by the tax was viewed in this light, the rest of the analysis was fairly straightforward. It followed that a higher standard of justification was required in order to sustain the tax (there must be "significant differences between the two classes" rather than merely a "rational basis" for the distinctions drawn) and, in turn, that the State's proffered justifications were insufficient to meet this elevated standard.

The relevant question now is not whether the Court was correct to regard the *Davis* tax as discriminatory against federal interests, but whether, as the *Swanson* court found, the Court's conclusion in this respect was unpredictable based on prior decisions. Was "new" law established in the judgment that the *Davis* tax discriminated against federal pensioners?

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[20] There are approximately 3½ million individual taxpayers in Virginia. The number of federal retirees is estimated at 200,000. There are approximately 60,000 state and local retirees (some of whom live outside Virginia), and there are somewhat over 200,000 private retirees. See JA 25.

[21] It seems clear that if the traditional equal protection "rational basis" test were the correct standard against which to measure the Michigan tax, it would have survived. *See Lehnhausen v. Lake Shore Auto Parts Co.*, 410 U.S. 356 (1973). It is likely that the tax would have survived this inquiry for the same reasons the federal government was allowed to give its retirees monetary benefits denied to state and private retirees in *Clark v. United States*, 691 F.2d 837 (7th Cir. 1982).

Close examination of this Court's opinion reveals that it was. The issue of discrimination is addressed in two places in the opinion. The first is a one-sentence assertion, without further elaboration or citation of authority: "It is undisputed that Michigan's tax system discriminates in favor of retired state employees and against retired federal employees." *Davis*, 489 U.S. at 814. The second is in the Court's answer in footnote 4 to Justice Stevens' dissent.[22]

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[22] That footnote reads in full:

> The dissent argues that this tax is nondiscriminatory, and thus constitutional, because it "draws no distinction between the federal employees or retirees and the vast majority of voters in the State." *Post*, at 823. In *Phillips Chemical Co.*, however, we faced that precise situation: an equal tax burden was imposed on lessees of private, tax-exempt property and lessees of federal property, while lessees of state property paid a lesser tax, or in some circumstances none at all. Although we concluded that "[u]nder these circumstances, there appears to be no discrimination between the Government's lessees and lessees of private property," 361 U.S., at 381, we nonetheless invalidated the State's tax. This result is consistent with the underlying rationale for the doctrine of intergovernmental tax immunity. The danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it. As we observed in *Phillips Chemical Co.*, "it does not seem too much to require that the State treat those who deal with the Government as well as it treats those with whom it deals itself." *Id.*, at 385.
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> We also take issue with the dissent's assertion that "it is peculiarly inappropriate to focus solely on the treatment of state governmental employees" because "[t]he State may always compensate in pay or salary for what it assesses in taxes." *Post*, at 824. In order to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefits payments instead of a tax exemption, the State would have to increase its outlays by more than the cost of the current tax exemption, since the increased payments to retirees would result in higher federal income tax payments in some circumstances. This fact serves to illustrate the impact on the Federal Government of the State's discriminatory tax exemption for state retirees. Taxes enacted to reduce the State's employment costs at the

Except for the reference to *Phillips Chemical* in footnote 4, no previous decisions by this Court or any other federal or state court are mentioned to support the conclusion that the tax in *Davis* worked a discrimination against the federal government or federal retirees.[23] The question arises, therefore, whether *Phillips Chemical* clearly foreshadowed the *Davis* decision within the meaning of *Chevron Oil*. The view that it did, we observe at the outset, must confront the fact that it was not until 1989 that it was discovered that this 1960 decision had an impact on the validity of a tax that had been in effect in almost half the states since at least 1942. That 29 years passed between *Phillips Chemical* and *Davis* (and that it did not occur to any taxpayer, tax attorney, state or federal court, or law review author that the *Davis* tax might be troublesome) is powerful testimony that it was far from obvious that *Phillips Chemical* led inexorably to the demise of the *Davis* tax.

Moreover, a careful reading of *Phillips Chemical* makes it understandable why no such conclusions were drawn. That case involved local property taxes on leasehold interests. Those who leased land from the owners of private property were not taxed.[24] Those who leased land from a private tax-exempt organization (a church or a charity) likewise were not taxed.[25] Those who, like Phillips Chemical Co., leased land

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> expense of the federal treasury are the type of discriminatory legislation that the doctrine of intergovernmental tax immunity is intended to bar.

489 U.S. at 815 n.4.

[23] There are likewise no prior cases predicting the Court's answer to the argument discussed in the second paragraph of footnote 4 in *Davis*. It will be noted that no cases or other prior authorities are cited for the Court's assertions in that paragraph. Moreover, had the state chosen to provide its retirees higher benefits rather than a tax exemption, the state tax paid on those benefits would have been deductible on the retirees' federal income tax returns. It is far from clear that there would have been any impact on the federal fisc had the state chosen this option rather than the tax exemption.

[24] Taxes in that instance were assessed against the owner-lessor.

[25] In this instance, the tax exemption did not survive the lease, and the owner-lessor again paid the tax.

from the federal government were taxed under Article 5248, which applied directly and explicitly to land "held, owned, used, and occupied by the United States." Those who leased land from the state or local governments were taxed under the different and less onerous provisions of Article 7173. Indeed, because of certain exemptions in Article 7173, Phillips Chemical Co. would have paid no tax if it had an identical lease from the state or local government. In this setting, the Court held that the tax under Article 5248 discriminated against the United States:

> [A]ll lessees of exempt public lands would appear to belong to the class defined by Article 7173. In view of the fact that lessees in this class are taxed because they use exempt property for a nonexempt purpose, they appear to be similarly situated and presumably should be taxed alike. Yet by the amendment of Article 5248, the Texas Legislature *segregated federal lessees* and *imposed on them a heavier tax burden* than is imposed on the other members of the class by Article 7173. . . . The discrimination against the United States and its lessee seems apparent.

361 U.S. at 381-82 (emphasis added). Once the Court had determined that the tax discriminated against the federal government, it followed that a higher than normal standard would govern the acceptability of the state's proffered justifications for the tax (there must be "significant differences" between federal lessees and state or local lessees rather than a "rational basis" for treating them differently). It also followed that the state's justifications did not measure up to this elevated standard.

Why did the Court in *Phillips Chemical* take the critical first step of concluding that the Texas tax discriminated against federal government interests? As appears from the quotation immediately above, the reason was that the tax statute on its face created a class of taxpayers that consisted of two (and only two) groups: (1) lessees from the federal government and (2) lessees from state or local government. Since these were the only two groups being taxed, and since both involved "use [of] exempt property for a nonexempt purpose, they appear(ed) to be similarly situated and

presumably should [have] be[en] taxed alike." Since a higher tax was imposed on federal lessees (and since the higher tax obviously made the federal government a less attractive landlord), "[t]he discrimination against the United States and its lessee seems apparent."[26]

The Court did note that "there appears to be no discrimination between the Government's lessee and lessees of private property." 361 U.S. at 381. It apparently reached this conclusion on the assumption that the full value of the taxes would be passed on to private lessees in their rents.[27] But this observation does not diminish the fact that the tax at issue in *Phillips Chemical* singled out federal government interests for the imposition of a special tax that was not imposed on anyone else and that reasonably could have been expected to affect the leasing operations of the federal government.[28] The *Davis* tax did not do this: it exempted retired

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[26] As Justice Stevens pointed out in his dissent in *Davis*, *Phillips Chemical* would have been on all fours with the *Davis* situation "if Michigan's income tax applied only to public employees; on that hypothesis, if state employees were exempted, the tax would obviously discriminate against federal employees." 489 U.S. at 825 (Stevens, J., dissenting).

[27] On this point the Court said: "The full value of the leased property becomes taxable to the owner, and the lessee's indirect burden consequently is as heavy as the burden imposed directly on federal lessees by Article 5248." 361 U.S. at 380-81.

This conclusion is surely plausible, but was not supported by the record and is not necessarily correct. It will not always be the case that leasehold rents will reflect property taxes on a dollar-for-dollar basis; other economic factors can easily intrude to push rents up or down independently of tax increases or savings. The Court in *Phillips Chemical* did not have occasion carefully to examine this point because the tax at issue was not defended on the ground that the federal government was not being discriminated against. The defense to the tax, by contrast, was that the differential treatment was justified.

[28] Historically, the intergovernmental tax immunity doctrine has restricted states from enacting taxes that "impede" the federal government in the "execution of [its] powers." *McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316, 436 (1819). See also the House Report's explanation of the "discrimination" language in § 111: "To protect the Federal Government against the unlikely possibility of State and local taxation which is aimed at, or threatens the efficient operation of, the Federal Government, the consent is expressly confined to taxation which does not discriminate against such officer or employee because of the source of the compensation."

state employees from a tax that by its terms was imposed on all other citizens with reportable income. Federal government interests were not singled out for special or differential treatment. And it was far from apparent that such a tax could have a detrimental effect on any operations of the federal government.

The Commonwealth knew that a tax that segregated federal interests for more burdensome treatment than imposed on other taxpayers would be difficult to justify under the doctrine of intergovernmental tax immunity. What the Commonwealth did not understand until *Davis* was that the tax at issue here would implicate the same concerns.[29] Unlike in *Phillips Chemical*, no special statute imposed a tax on retired federal employees. They were treated in Virginia just like all retirees from private employment, and indeed just like all employed taxpayers. Virginia did make special provisions for its own retired employees, and it chose to do so in the form of a tax exemption rather than a cash payment. Had it made a cash payment instead, it is inconceivable that there would have been any basis for objection because it did not also make a cash payment to retired federal employees. It seemed to any careful tax lawyer or state official to make no difference that a tax exemption was the form in which Virginia dispensed a

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H.Rep. No. 26 at 5, 76th Cong., 1st Sess. (1939). And see *United States v. City of Manassas*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 485 U.S. 1017 (1988). In that case, as in *Phillips Chemical*, a local tax was struck down that singled out federal interests for the imposition of a tax that was not imposed on non-governmental entities, that exempted certain state interests from payment of the tax, and that directly affected the cost of services supplied to the United States. The fact of discrimination was taken as given, and the focus was on whether the differential treatment could be justified. Neither *Phillips Chemical* nor *Manassas* provided any guidance on the issue in *Davis* that is critical now, namely, how the Michigan tax could be held to discriminate against federal interests.

[29] The principle that state taxes could not discriminate against federal interests was, of course, well established prior to *Davis*. Petitioners and some of the amici think this sufficient to warrant the conclusion that no "new" principle of law was established by *Davis*. E.g., Pet. Br. at 11 n.6. But the longevity of the principle does not mean that all of its applications are clearly forecasted. The issue here is how predictable it was prior to *Davis* that the Michigan tax offended that principle. The resolution of that question, as Petitioners' own failure to challenge the tax prior to *Davis* so eloquently demonstrates, is what was "new" about *Davis*.

fringe benefit to its own employees. The holding in *Davis* was that the form of the fringe benefit made a fatal difference. But so far as the *Davis* opinion and the Commonwealth's independent research reveal, there is no basis in prior decisions for one to have foreseen that the Court would conclude that the Michigan tax discriminated against retired federal employees.

2. Retroactive application of *Davis* would not further the operation of its rule.

Under the second *Chevron Oil* factor, the Court is to "weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." 404 U.S. at 106-107, *quoting Linkletter v. Walker*, 381 U.S. 618, 629 (1965). It is clear that retroactive application is not necessary to "further" the rule announced in *Davis*. The Virginia General Assembly met in Special Session shortly after the March 28, 1989, decision in *Davis* and repealed the full subtraction for state and local government retirement benefits, effective retroactively to January 1, 1989, replacing it with a partial subtraction for all retirees. At no time after the *Davis* decision have the pension benefits of state and local government retirees been treated differently from the pension benefits of federal government retirees. The requirements of *Davis* have been met.

Petitioners argue that various compensatory and deterrence interests will be "furthered" by requiring Virginia to refund taxes which it had no reason to know were not validly assessed. Petitioners begin by asserting that taxpayers have legitimate compensatory interests safeguarded by the Supremacy Clause. Pet. Br. at 32-33. But, to the contrary, there is substantial doubt whether Petitioners have any compensatory interest at all.[30] The purpose of § 111 is not to prohibit

[30] Petitioners claim that "the revenue generated by the excessive taxes imposed on petitioners should have been raised by a nondiscriminatory tax on the population as a whole." Pet. Br. at 35. If the taxes foregone by the exemption of the modest state retirement income of some 50,000 retirees had been raised by a tax on the population as a whole, the corresponding reduction in Petitioners' tax liability for the years 1984 through 1989 would clearly have been minuscule. In 1982, the average Virginia federal civil retiree income was $15,416, while the average state retiree received $4,020 annually. *See* SA 20 (Comparative chart attached to Report of the House Finance Retirement Subcommittee, Dec. 1982, cited in Brief Amicus Curiae on Behalf of the Military Coalition in Support of Petitioners).

taxation but to permit taxation.[31] These taxpayers have no constitutional or federal statutory right to a tax *exemption*. The constitutional right they assert is not a traditional personal right, such as freedom of speech or religion or the freedom from illegal searches and seizures. It is not even about the freedom to be able to compete in interstate commerce. In fact, this case is not even about discrimination in any ordinary sense. This case is about intergovernmental relations, about the relationship between state and federal government. As the Court in *Davis* states, "intergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other." 489 U. S. at 814. It would retard rather than further this interest for this Court to require a state to redistribute huge sums of public moneys to a group of taxpayers who have suffered no harm to a right that is personal to them.[32]

[31] *See* H. Rep. 26 at 5, 76th Cong., 1st Sess. (1939) ("In order to *facilitate reciprocal taxation* as between State and Federal Governments, your committee believes that the United States should expressly consent to the taxation of the compensation of its officers and employees." (Emphasis added.))

[32] Any argument that the payment of refunds to Petitioners will in some way benefit the federal government by recompensing the federal fisc is speculative and plainly irrelevant. Moreover, there is no support for the view that the purpose of § 111 was to increase revenues in the federal fisc. Under § 111 and Davis states could validly choose not to exempt either federal or state retirement income. This approach would *reduce* federal tax revenues in that both federal and state retirees would then have state tax liabilities to deduct in calculating their federal tax liability.

It also cannot be convincingly argued that the federal government or its employees have unfairly subsidized state employment costs. Virginia's employment costs would not have been higher had it chosen, in the language of *Davis*, "to provide the same after-tax benefits to all retired state employees by means of increased salaries or benefits instead of a tax exemption." 489 U.S. at 803 n.4. The citizens of a state receive the benefit of the services provided by state employees

The argument that retroactive application of *Davis* is necessary as a punitive remedy against the Commonwealth to deter future invalid tax statutes is not only totally without merit but also is, under the facts of this case, unfair to the Commonwealth and its citizens. The tax exemption challenged here was enacted in 1942. No intervening events gave fair warning that the tax was inconsistent with federal law. Immediately after *Davis*, the legislature amended the statute in a manner that fully complies with the *Davis* holding. The court below specifically found: "[N]othing in the record suggests that the Commonwealth acted other than in good faith reliance upon a presumptively valid taxing statute." *Harper I*, 241 Va. at 236, 401 S.E.2d at 871 (SA 7). There is nothing in these facts for which the state, its legislature and its citizens should be "punished."

The argument that punitive remedies against a state are necessary to deter future invalid tax statutes was also made in *ATA v. Smith*: "Petitioners argue that the retroactive application of *Scheiner* will tend to deter future free trade violations which the several States have strong parochial incentive to commit." 496 U.S. at 181. The plurality rejected this argument in one sentence: "As we have just discussed, however, the . . . tax was entirely consistent with [prior law] and it is not the purpose of the Commerce Clause to prevent legitimate state taxation of interstate commerce." *Id.* Here, too, it is not the purpose of the Supremacy Clause or the doctrine of intergovernmental tax immunity to punish state actions taken in good faith. This Court has held in other contexts that prospective relief alone is sufficient to protect federal supremacy interests. *See Green v. Mansour*, 474 U.S. 64, 68 (1985) (holding that state had no obligation to provide retroactive monetary relief for wrongfully withheld welfare payments). The purpose of the intergovernmental tax immunity

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and pay for those services in one way or another. Moreover, since there were only 51,344 state retirees in Virginia in 1987, and a total of 2.56 million tax returns, JA 25, the state income tax foregone by the exemption represents a *de minimis* "subsidy" to employment costs by other citizens of the state.

doctrine likewise will be fully served if *Davis* is given only prospective effect.

3. Retroactive application of *Davis* in this case would result in inequity, injustice, and hardship to the citizens of the Commonwealth.

The third *Chevron Oil* factor requires a court to consider the inequity, injustice, and hardship imposed by retroactive application of a new judicial decision. *Chevron Oil*, 404 U.S. at 107. There can be no dispute that the imposition of a refund liability on the Commonwealth in an amount approaching $500 million will result in extreme hardship to the Commonwealth and its citizens. *See, e.g.*, JA 30-31, 33, 37-38, 41-43, 46. Virginia citizens will be affected by some combination of an increase in taxes at a time when few can afford it[33] or a reduction in services at a time when services are already being cut by current economic necessities.[34] Those who will suffer the most will be those who are the least able fully to provide for their own needs.

This Court has previously recognized the fiscal realities confronting state governments compelled to cope with massive budget deficits and adversely changing economies. Pointing to these considerations, Justice Powell, writing for five Justices in *Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris*, 463 U.S. 1073 (1983), concluded that the imposition of retroactive monetary liability amounting potentially to hundreds of millions of dollars against the state of Arizona would be inappropriate even though the state was found to have violated Title VII in its administration of a state retirement plan. He

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[33] The estimated liability in Virginia is the rough equivalent of 22% increase in the state sales tax (from 4.5% to 5.5%) or a surcharge of 13.6% on top of the state income tax owed by each and every individual taxpayer in Virginia. SA 3.

[34] State agency budgets have already been reduced for other reasons to a level that is 25% below 1990 funding levels, and state jobs have been eliminated through early retirements and layoffs. SA 3.

recognized that "[i]mposing such unanticipated financial burdens would come at a time when many state and local governments are struggling to meet substantial financial deficits," *id.* at 1106-07, and concluded that because the legality of Arizona's conduct had not been settled until the *Norris* decision, there was "no justification . . . to impose this magnitude of burden retroactively on the public." *Id.* at 1107. Similarly, in *Los Angeles Department of Water and Power v. Manhart*, 435 U.S. 702 (1978), in a holding from which, on this point, only Justice Marshall dissented, the Court concluded that, despite the presumption in favor of retroactive relief for a violation of Title VII, the granting of retroactive relief by the lower court was in error. Justice Stevens stated for the Court:

> There can be no doubt that the prohibition against sex-differentiated employee contributions represents a marked departure from past practice. Although Title VII was enacted in 1964, this is apparently the first litigation challenging contribution differences based on valid actuarial tables. Retroactive liability could be devastating for a pension fund. The harm would fall in large part on innocent third parties.

435 U.S. at 722-23.[35]

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[35] *See also City of Newport v. Fact Concerts, Inc.*, 453 U.S. 247, 267 (1981) (when liability is imposed on a government, the ultimate burden falls not on the "government," but on "the shoulders of blameless or unknowing taxpayers"); *Edelman v. Jordan*, 415 U.S. 651 (1974). There is no general principle of federal law that government should always shoulder the burden of retroactive relief to all plaintiffs for all kinds of injuries in all contexts. Petitioners' reference to *Owen v. City of Independence*, 445 U.S. 622 (1980), is simply irrelevant. Pet. Br. at 22. The issue presented in *Owen* was whether local government officials were entitled to a form of the qualified immunity defense afforded to many § 1983 defendants. It does not stand for the proposition that government is always retroactively liable in compensatory damages for unforeseen changes in the law, nor does any other case ever decided by this Court. Rather, it implements the particular compensatory policies reflected in a federal statute the very purpose of which is to provide remedies for certain constitutional violations and that explicitly does not include liability imposed on the state itself. *See Will v. Michigan Dep't of State Police*, 491 U.S. 58 (1989). Eight Justices in *ATA v. Smith* rejected the argument that *Owen* holds that constitutional decisions always apply retroactively against the government. 496 U.S. at 184, 216 n. 5.

The argument that fairness requires that Petitioners, who claim to "have paid more than their fair share" of taxes, Pet. Br. at 35, should be reimbursed is illogical. It is not just the state and local government retirees, the only group that has been paying less than all other recipients of retirement income, who will be required to pay any refunds. The refund liability will fall on all taxpayers of the Commonwealth, including not only Petitioners but also hundreds of thousands of private pension recipients who have no claim for monetary relief whatsoever. It is unfair to the citizens of the Commonwealth to impose on them retrospective monetary liability because a small group of some 50,000 civil servants benefited from a state income tax subtraction that had been in effect for half a century and that was declared illegal based on an unforeseeable development in the law. There is no justice or equity in such a result.

Petitioners contend that the Commonwealth's equitable argument is weakened by the decision of the General Assembly to extend a tax exemption to federal and private retirees rather than to terminate the exemption for state retirees. Pet. Br. at 36 n.23. Further, Petitioners argue, the Commonwealth could have limited its exposure to refund liability by not adopting a special statute of limitations expanding the period for federal retirees to file claims for refunds. Pet. Br. at 37.

Ironically, Petitioners assert that because the Commonwealth acted in a fair and equitable manner, it cannot now assert an equitable argument.

It is indeed true that the Commonwealth could have removed all exemptions for retirement benefits, including those of its civil servants who had relied on the exemption. But it could do so only by walking away from a long-standing covenant with state employees and retirees. The Commonwealth chose instead to honor its commitment to its employees and retirees. It would turn equity on its head to hold that because the Commonwealth acted out of a duty of fairness to its civil servants it cannot now be heard to argue that the rest of its citizens deserve to be treated fairly as well.

It is also true that the Commonwealth need not have extended the statute of limitations for federal retirees. The

Commonwealth could have required all federal retirees to retain accountants and to file amended returns or to hire attorneys and rush to the courthouse to preserve their claims, despite the fact that such actions would be of no benefit to the retirees absent a final court ruling that refunds were mandated. But, again, this choice would not be consistent with the Commonwealth's notions of fairness to its citizens. Virginia chose not to act punitively or restrictively toward its federal retirees, even in the face of claims of potentially crippling liability and even in the face of its resolution to oppose the claims on the merits.

The actions of the General Assembly following *Davis* are indisputable examples of the fair manner in which the Commonwealth deals with its taxpayers. To argue that the Commonwealth should now be punished for these actions can only be viewed by this Court as absurd.

There can be no question where the equities lie in this case. This is not a case of intentional government overreaching or impropriety. This is not a case where personal constitutional rights have been infringed by the inattention of government officials to fundamental constitutional principles. This is a case where an abstract principle of intergovernmental tax immunity was interpreted by the Court in an entirely unanticipated manner to strike down a tax policy employed by the Commonwealth and 22 other states in good faith for almost 50 years. These Petitioners could have objected to the Virginia tax before they paid it. They, or others like them, could have objected at any point over the past 50 years. One suspects that the reason they did not do so is that they did not realize, any more than did the Commonwealth, that the taxes offended federal law. The indignation with which they now assert their newly discovered claim is, when stripped of its rhetoric, an argument that they should receive an unanticipated windfall that would impose significant and hurtful consequences on their fellow taxpaying citizens in the communities where they live. The principles of federal law on which the *Davis* decision rests are fully satisfied, fully implemented, and fully respected by the prospective relief from

differential tax treatment which these Petitioners have already received. They are entitled to no more.

II. There is no requirement in federal law that Petitioners be afforded a retrospective refund remedy for taxable years concluded before *Davis*.

If *Chevron Oil* leads to the conclusion, as it should, that *Davis* is not to be retroactively applied to these Petitioners, this case is at an end. The Virginia Supreme Court decision must then be affirmed. But if this Court should decide that *Davis* did create retrospective rights in these Petitioners, two further issues remain.

The first is purely a question of state law. This Court's decisions establish that the scope of the available remedies in a case such as the present one is initially to be determined by reference to state law. *See Beam*, 111 S. Ct. at 2443; *McKesson*, 496 U.S. at 32 n. 16; *ATA v. Smith*, 496 U.S. at 176. In this case, the Virginia Supreme Court held, for reasons that have not been challenged by Petitioners as inadequate or not independent of federal law, that no state remedy is available. This conclusion is based, as discussed below, on state-court decisions that long pre-date the *Davis* litigation.

This resolution of the state law issue gives rise to a second question, namely whether federal due process limitations are offended by the unavailability of retrospective refund relief under state law. For two independent reasons discussed below, it is clear that due process does not require that Petitioners be afforded a remedy in this case. The first is that equitable considerations may appropriately be considered to foreclose the necessity of retrospective relief on facts such as these. The prospective relief already obtained by Petitioners is a fully adequate recognition of their federal rights. The second has to do with the timing of remedies available under state law. *McKesson* held that post-payment relief is required only if the state compelled the taxpayer to pay first and protest later. Under Virginia law, in contrast, all taxpayers are given an opportunity to obtain pre-payment relief. The availability of such relief, and the failure of these Petitioners

to seek it, forecloses any claim they would now make that federal law requires an additional, retrospective refund remedy when that relief is not available under clearly established state law.[36]

A. There is no retrospective refund remedy now available to Petitioners under state law.

In Part I of its opinion in *Harper I*, the Virginia Supreme Court addressed the *Chevron Oil* issues presented by this case. It then turned in Part II to a discussion of remedial issues. Petitioners had argued that they were entitled to a remedy under state law even if it were determined that *Davis* did not apply retroactively. The court first rejected that argument: "[B]ecause the *Davis* decision is not to be applied retroactively, the pre-*Davis* assessments were neither erroneous nor improper within the meaning of Code § 58.1-1826."[37] 241 Va. at 241, 401 S.E.2d at 873 (SA 12).

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[36] It follows from this discussion, indeed, that Part II of the decision in *Harper I* constitutes an adequate and independent state ground of decision that could foreclose the necessity of resolving the retroactivity issue raised by Petitioners.

[37] Section 58.1-1826 provides in full as follows:

> If the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order that the assessment be corrected. If the assessment exceeds the proper amount, the court may order that the applicant be exonerated from the payment of so much as is erroneously or improperly changed, if not already paid and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the court shall order that the applicant pay the proper taxes and to this end the court shall be clothed with all the powers and duties of the authority which made the assessment complained of as of the time when such assessment was made and all the powers and duties conferred by law upon such authority between the time such assessment was made and the time such application is heard. The court may order that any amount which has been improperly collected be refunded to such applicant. A copy of any order made under this section or § 58.1-1827 correcting an erroneous or improper assessment shall be certified by the clerk of the court to the Tax Commissioner.

The court then advanced an independent ground for the conclusion that Petitioners were not entitled to the remedy they were seeking:

> Harper's state-law contention also fails for another reason. We previously have held that this Court's ruling declaring a taxing scheme unconstitutional is to be applied prospectively only. *Perkins v. Albemarle*, 214 Va. 240, 198 S.E.2d 626, *aff'd and modified on rehearing*, 214 Va. 416, 200 S.E.2d 566 (1973). We adhere to our holding in *Perkins*. In so doing, we follow the criteria stated in *Fountain v. Fountain*, 214 Va. 347, 348, 200 S.E.2d 513, 514 (1973), *cert. denied*, 416 U.S. 939 (1974), that "consideration should be given to the purpose of the new rule, the extent of the reliance on the old rule, and the effect on the administration of justice of a retroactive application of the new rule." *See also Quick v. Harris*, 214 Va. 632, 634, 202 S.E.2d 869, 871 (1974), *cert. denied*, 420 U.S. 907 (1975).

241 Va. at 241-42, 401 S.E.2d at 873-74 (SA 12-13) (footnote omitted[38]).

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[38] The omitted footnote followed the citation to *Perkins* in the above quotation. That footnote read:

> The case of *Capehart v. City of Chesapeake*, No. 5459 (Circuit Court, City of Chesapeake, decided Oct. 16, 1974), followed *Perkins*. In *Capehart*, more than one hundred taxpayers in the City of Chesapeake, who had been subjected to the same practice that was invalidated in *Perkins*, brought suit in circuit court seeking, among other things, refunds on the taxes "illegally and unconstitutionally assessed." The City demurred, citing *Perkins*. The circuit court sustained the demurrer, being of opinion that the case was controlled by *Perkins*. We denied Capehart's petition for appeal, 215 Va. xlvii, and Capehart's petition for certiorari rasing due process grounds was denied by the Supreme Court, 423 U.S. 875, 96 S.Ct. 148, 46 L.Ed.2d 109 (1975).

241 Va. at 241 n. 3, 401 S.E.2d at 874 n.3 (SA 12-13). Under Virginia practice, the denial of a petition for appeal is a decision on the merits. *See Sutherland v. Swannanoa Corp.*, 189 Va. 149, 52 S.E.2d 92 (1949).

Perkins and *Capehart* interpreted an earlier and similarly worded refund statute for local tax assessments[39] not to require refunds in cases where settled expectations were upset by a ruling that a tax was unconstitutional.[40] In *Harper I*, which was reaffirmed by the court "in all respects" in *Harper II*, the Virginia Supreme Court held that state law does not entitle Petitioners to a refund of the challenged taxes for the same reasons the *Perkins/Capehart* plaintiffs were not entitled to retroactive refunds in 1973. It was thus a well-settled feature of Virginia law that equitable considerations were to determine the retrospective reach of decisions holding tax statutes unconstitutional.[41] Taxpayers were (and are) entitled under state law only to prospective relief.[42]

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[39] Va. Code § 58-1148 (Repl. Vol. 1969) (currently § 58.1-3987) stated, in relevant part: "If the court be satisfied from the evidence that the assessment is erroneous . . . the court may order that the assessment be corrected. If, in the opinion of the court, the assessment exceeds the proper amount, the court may reduce the assessment to what in its opinion based on the evidence is the fair market value of the property involved and shall order that the applicant be exonerated from the payment of so much as is erroneously charged, if not already paid and, if paid, that it be refunded to him."

[40] Under Virginia law, a Supreme Court interpretation of statutory language is deemed to be acquiesced in by the legislature if not overturned by subsequent legislation. *See, e.g., Burns v. Stafford County*, 227 Va. 354, 360, 315 S.E. 2d 856, 860 (1984).

[41] It should be noted that at no point in *Perkins*, *Capehart*, or its discussion of these cases in *Harper I* or *Harper II* did the Virginia Supreme Court cite any federal cases or make any reference to federal law. This case thus does not present the problem before the Court in *Michigan v. Long*, 463 U.S. 1032 (1983), of whether the state court decision was "independent" of federal law. It will also be noticed, moreover, that *Perkins* and *Capehart* were decided long before the *Davis* controversy arose.

[42] In their present brief on the merits filed in this Court, Petitioners assert for the first time that if they are not entitled to relief under state law, they are entitled to relief under the United States Constitution. Pet. Br. at 40. Even if this argument had any validity – a question that presents substantial difficulties of its own, *see Schweiker v. Chilicky*, 487 U.S. 412 (1988) – it comes too late. Petitioners' sole claim for relief in the courts below was based on Va. Code § 58.1-1826. JA 5-21. Petitioners have never asserted a claim for relief under the federal Constitution and it is far too late for them to do so now.

B. Federal due process concerns are not offended by limiting the state remedy to prospective relief.

Petitioners raise in this Court a Fourteenth Amendment due process argument that appears neither in their complaints (JA 5-21) nor their assignments of error to the Virginia Supreme Court below (JA 69). Petitioners argue that, if *Davis* is retroactive under federal law, the failure of the State to supply a retrospective refund remedy would violate due process principles enunciated in *McKesson*. Because this argument was not properly before the Virginia Supreme Court and was not addressed by that court, it is too late to raise it now.[43] The argument fails on the merits in any event because Virginia's tax refund statutes and procedures, including the limitation on refunds invoked in this case, fully satisfy the federal constitutional demands of due process.

(1) *Petitioners misconstrue* McKesson. Petitioners misread *McKesson* when they argue that that case requires a retrospective remedy here. The Florida tax at issue in *McKesson* post-dated the ruling of the Supreme Court in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 264 (1984), which declared a liquor tax in Hawaii unconstitutional under the Commerce Clause. Florida's previous tax system had been essentially the same as the system invalidated in *Bacchus*. Florida then amended its law in response to *Bacchus*, and it was this amended statute that was held unconstitutional by the Florida courts because it did not comply with the mandate of *Bacchus*.[44] The taxpayers sought the refund of taxes paid under the amended, but virtually identical, statute. It is important to note that they sought no refunds for taxes paid *prior* to *Bacchus*.

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[43] Under Virginia law, the Supreme Court can only consider such errors as are presented to it by appropriate assignments of error. *Wash v. Holland*, 166 Va. 45, 183 S.E. 236 (1936).

[44] This Court referred to the changes adopted in response to *Bacchus* as "only cosmetic." *McKesson*, 496 U.S. at 46.

In the case now before this Court, the Commonwealth promptly called a Special Session of its legislature and amended its tax system in response to *Davis*. Unlike *McKesson*, no challenge to the constitutionality of the amended statute has been or could be made here. Rather, Petitioners seek the refund of taxes paid under the statute now repealed, thus seeking the refund *only* of taxes for liabilities established *prior* to *Davis*,[45] taxes imposed before the Commonwealth had any notice that the taxes were subject to challenge.

McKesson establishes that, absent a predeprivation remedy, prospective-only relief is inadequate where it is entirely foreseeable at the time of enactment that a tax will be contested and likely invalidated. Fundamental fairness dictates that a state may not enact a tax statute which it knows or should know is unconstitutional, require that taxpayers pay the tax until the statute is invalidated by the highest court, and then deny the taxpayers any remedy for the period the statute was in effect.[46] Such a result violates fundamental fairness and properly destroys any equitable justification for denying retrospective relief. *McKesson*, 496 U.S. at 44-46.

It does not follow in all cases where state tax statutes are held in conflict with federal law, however, that a state may not consider equitable factors in determining whether retrospective relief is necessary or appropriate. In *McKesson*, the state presented various equitable arguments to justify the denial of retrospective relief, including the state's ability to engage in sound fiscal planning. The Court did not hold that

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[45] It is the date of the attachment of tax liability rather than payment of the tax that is determinative. *See ATA v. Smith*, 496 U.S. at 186-88. Thus, the fact that some taxes for taxable year 1988 may have been *paid* in 1989 after the March 1989 date of *Davis* is irrelevant.

[46] Indeed, the question presented by the Supreme Court for reargument in *McKesson* was whether a state must provide some form of retrospective relief when a taxpayer pays a state tax found to violate "clearly established law" under the Commerce Clause. *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco*, 492 U.S. 915 (1989) (order requesting supplemental briefing). The issue presented was a narrow one.

such equitable principles are never to be considered in a case in which a tax is found to violate federal law.[47] Rather, the Court considered the state's equitable arguments and found them not to be "weighty" in a circumstance where the most critical equitable factor – a state's good faith reliance on a presumptively valid state statute – was absent.

Before *Davis*, the Commonwealth had no indication from prior judicial decisions or from any retired federal employees in Virginia that the taxes were of questionable validity. There were, to be sure, lobbying efforts for more favorable tax treatment to retired federal employees, but importantly there is no indication that they were at any time based on claims of legal invalidity of the tax. Moreover, the fact that retirees pursued legislative remedies and never pursued administrative or judicial remedies further confirmed that they conceived the issue to be one of policy, not legality. The Commonwealth had no reason in the tax years at issue here – 1985 through 1988 – to refrain from collecting the taxes or to escrow the

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[47] In fact, this Court has held that the federal government is not required to refund taxes paid without notice of challenge, despite a provision in the Internal Revenue Code authorizing the refund of taxes "wrongfully collected." *United States v. New York & Cuba Mail S.S. Co.*, 200 U.S. 488 (1906). *New York & Cuba Mail S.S. Co.* was cited in *United States v. Mississippi Tax Commission*, 412 U.S. 363, 368 n. 11 (1973), as authority for the proposition that recovery may be denied of taxes voluntarily paid pursuant to an illegal demand. In *New York & Cuba Mail Steamship Co.*, the United States conceded that a stamp tax was unconstitutional but argued that no recovery of the taxes paid was due because the tax was paid voluntarily and without protest. Although there were severe penalties for not paying the tax, at the time the tax was paid the Collector was not informed, orally or in writing, that the taxpayer claimed that the law was unconstitutional or that he was paying under duress. The Court concluded that such payment must be deemed voluntary and not subject to recovery. 200 U.S. at 494. This conclusion was not affected by a statutory provision authorizing the Commissioner of the Internal Revenue to "refund . . . and pay back all taxes . . . that appear to be unjustly assessed or excessive in amount, or *in any manner wrongfully collected*." *Id.* at 495 (emphasis in original). The taxpayer argued that this provision rendered protest or notice unnecessary for his protection. The Court disagreed, holding that protest or notice, while not statutorily required, "was clearly demanded for the protection of the government in conducting the extensive business of dealing in stamps, which were sold and delivered in quantities, and without it there would not be the slightest vestige of involuntary payment." *Id.*

taxes collected.[48] The General Assembly took immediate action following *Davis* to align Virginia's tax system with the requirements of that decision. Petitioners accordingly have received the benefit of that decision for all tax years since *Davis* and will continue to do so. Due process does not require that they receive any more than that.

Due process is founded on notions of fundamental fairness and a balancing of the governmental and private interests in each case. *Mathews v. Eldridge*, 424 U.S. 319 (1976); *Wolff v. McDonnell*, 418 U.S. 539 (1974). It would be fundamentally unfair to the taxpayers of the Commonwealth for the Court to hold in this case that, despite its factual differences from *McKesson*, due process requires a retrospective remedy. A balance of the equities supported backward-looking relief in *McKesson*; it supports prospective only relief in this case.

(2) *The decision below is consistent with* ATA v. Smith. The limitation of the remedy here to the prospective relief already obtained by Petitioners is also consistent with both this Court's decision and its dissent in *ATA v. Smith*. The plurality opinion in that case adheres to *Chevron Oil*, and under that test no refunds are required here. The dissent does not dispute the propriety of denying retroactive relief in an appropriate case:

[48] The Court noted that Florida could have refrained from collecting the taxes once they had been declared unconstitutional by the state court, pending further review, or could have placed the challenged taxes in an escrow account during this period. *McKesson*, 496 U.S. at 44-46. Had it done so, it would not then have faced the possibility of economic disruption. These options were not available to the Commonwealth. Unlike the taxpayers in *McKesson*, who challenged the Florida tax shortly after it was enacted, the taxpayers in this case had paid the taxes without protest during the period at issue. Payment under protest is not required in Virginia to preserve a taxpayer's right to seek a refund. However, the absence of any protest when the means to protest are clearly available to the taxpayer under state law is a factor supporting the conclusion that the Commonwealth, unlike Florida in *McKesson*, was justified in relying on the validity of its statute prior to *Davis*.

> [A]dherence to legal principle requires that we determine the rights of litigants in accordance with our best current understanding of the law. That current understanding may include judicial principles of res judicata and *stare decisis* and legislatively prescribed statutes of limitations that protect interests in reliance and repose. It may also include a law of damages that recognizes reliance interests.

496 U.S. at 214 (Stevens, J., dissenting).[49] It adopts the view expressed by Justice Harlan in *United States v. Estate of Donnelly*, 397 U.S. 286 (1970), in explaining the distinction between retroactivity as a choice of law principle and "the recognition of reliance as an element of the damages determination after a new principle of law has been applied." *Id.* As Justice Harlan stated:

> The impulse to make a new decisional rule nonretroactive rests, in civil cases at least, upon the same considerations that lie at the core of *stare decisis*, namely to avoid jolting the expectations of parties to a transaction. Yet once the decision to abandon precedent is made, I see no justification for applying principles determined to be wrong, be they constitutional or otherwise, to litigants who are in or may still come to court. . . .
>
> To the extent that equitable considerations, for example, "reliance," are relevant, I would take this

[49] The dissent described *Chevron Oil* as "establish[ing] a remedial principle for the exercise of equitable discretion by federal courts and not, as the plurality states, a choice of law principle applicable to all cases on direct review." 496 U.S. at 220 (Stevens, J., dissenting). It offered a similar explanation for a series of other Supreme Court decisions that declined to award retroactive relief.

One is entitled to assume that if it is consistent with due process for the federal courts to consider equitable considerations as a basis for denying retroactive compensatory relief in appropriate cases, it is likewise consistent with due process for the state courts to do so. Thus, the theory of the *ATA* dissent – which recognizes the correctness of prior denials of retroactive relief by the federal courts and which remands remedial issues in the present context to state law in the first instance – fully supports the Virginia Supreme Court decision in this case. That decision withholds a state refund remedy on the basis of equitable considerations similar to those invoked in *Chevron Oil*. This is exactly what the dissent in *ATA* contemplates.

> into account in the determination of what relief is appropriate in any given case. There are, of course, circumstances when a change in the law will jeopardize an edifice which was reasonably constructed on the foundation of prevailing legal doctrine. Thus, it may be that the law of remedies would permit rescission, for example, but not an award of damages to a party who finds himself able to avoid a once-valid contract under new notions of public policy.

Estate of Donnelly, 397 U.S. at 295-97 (Harlan, J., concurring), quoted in *ATA v. Smith*, 496 U.S. at 214-15 (Stevens, J., dissenting). Certainly *Davis* represented a "change in the law" that jeopardized "an edifice which was reasonably constructed on the foundation of prevailing law." And, like Justice Harlan's rescission example, adjustment of the future relations of the parties is an appropriate and sufficient remedy in the present case. We know from the decision below that, given the balance of equitable considerations in this case, an "award of damages" in the form of a retrospective refund is not permitted under the state law of remedies. Federal law does not require a different result.

(3) Beam *does not require a retrospective remedy*. It can be added that the denial of a retrospective remedy is also fully consistent with this Court's decision in *Beam*. As Justice Souter's opinion announcing the judgment of the Court pointed out, the issue resolved in that case was "narrow." 111 S. Ct. at 2448. *Beam* rejected the concept of selective prospectivity. It did not speculate as to the bounds or propriety of pure prospectivity. And importantly:

> Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by reference to our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with, or their consideration obviated by, issues of state law." *Bacchus*, 468 U.S., at 277. Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal.

111 S. Ct. at 2448.

Here, unlike in *Beam*, remedial issues were fully considered below. The Virginia Supreme Court accepted the invitation in *Beam* to "consider[] . . . individual equities when deciding [the] remedial issues in [this] particular case[]." 111 S. Ct. at 2448. The court below applied established precedent that had resolved the matter under Virginia law in 1973. *Harper I*, 241 Va. at 241-42, 401 S.E.2d at 873-74 (SA 12-13). This state law basis for the decision below is entirely permissible under *Beam*, as well as *ATA v. Smith* and *McKesson*.

(4) *Section 111 does not require a retrospective remedy*. Petitioners argue that, nonetheless, the separation of powers doctrine requires that full retroactive effect must be given to *Davis* because any disposition other than full retroactivity would result in a judicial declaration of the effective date of a Congressional enactment. Indeed, Petitioners assert that this is the most "fundamental" reason that they are entitled to refunds. Pet. Br. at 4, 11-19.

But this argument, never made to the court below, plainly misses the mark. Section 111 says nothing at all about *remedies*. Whether looked at through the filter of the retroactive application of the decision in *Davis* or through the filter of equitable flexibility in the law of remedies, there is nothing in the language or history of § 111 that suggests that Congress addressed the question of what remedies, if any, should be provided in the event that its anti-discrimination principle were violated. Retrospective remedies have been eschewed by this Court in the face of congressional silence in contexts where other anti-discrimination principles have been at stake. *See, e.g., Norris*, 463 U.S. at 1105-07; *Manhart*, 435 U.S. at

718-23.[50] There is nothing in the text or history of § 111 to require a different result here.

Petitioners' argument is also wrong for another reason. It is common ground that Virginia's three year statute of limitations[51] is an adequate and independent state ground that forecloses any relief to retired federal employees for taxes prior to 1985. The principle underlying this conclusion must be that the text and history of § 111 do not require, under the Supremacy Clause, that the state interests of reliance and repose reflected in its statute of limitations be overridden by superior federal principles. There is no reason why a similar principle of reliance and repose cannot operate for the years in litigation here, 1985 through 1988. The state law of remedies has been interpreted by the Virginia Supreme Court below to be governed by equitable considerations that preclude the award of a retroactive refund remedy on the facts now before the Court. There is no reason in the text or history of § 111 – or in this Court's prior jurisprudence – why the state law of remedies cannot perform for the years 1985 through 1988 the function performed by the state statute of

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[50] Indeed, it does not follow, as Petitioners apparently would have it, that retrospective compensatory relief is the automatic corollary of a finding of unconstitutionality by this Court, even in areas where extremely important individual liberties are concerned. The school children who had been denied equal educational opportunities before *Brown v. Board of Education*, 347 U.S. 483 (1954), and the citizens whose votes had been diluted before *Reynolds v. Sims*, 377 U.S. 533 (1964), were never compensated retrospectively. There is a much less compelling case for such relief here. The unconstitutionality of which Petitioners complain does not find its origins in the personal rights of individual liberty protected by the Bill of Rights and the Fourteenth Amendment. *Davis* relied on a principle designed to order governmental relations, not the relations between citizen and government – a factor that distinctly weakens, if indeed it does not entirely eliminate, the compensatory interests that Petitioners can place on the scale of equities to be weighed in this case. The fact that Petitioners have *standing* to invoke the principle of intergovernmental immunity does not mean that they should have an interest in retrospective compensatory relief for unforeseeable changes in the law. The reasons for recognizing their standing to challenge the *Davis* tax are fully served by affording them the prospective relief which they have already received. The doctrine of intergovernmental immunity on which *Davis* relies has been fully vindicated.

[51] Va. Code § 58.1-1825.

limitations for the years 1942 through 1984. Both concepts were clearly announced features of Virginia law long before the *Davis* litigation arose. Neither is fundamentally unfair.

Petitioners themselves have recognized that it is appropriate for the state law of remedies to take equitable considerations into account. In their Petition for a Writ of Certiorari in this case, they said:

> Petitioners adopt the position taken by Justice Stevens in *American Trucking Assn's v. Smith*, 110 S. Ct. at 2350, i.e., that courts enjoy latitude in fashioning equitable remedies, but that in deciding substantive questions of law, they are bound "to determine the rights of litigants in accordance with [their] best current understanding of the law." Thus, *Chevron* analysis would be relevant only to determining, within constitutionally permissible bounds, an appropriate remedy.

Petition for Certiorari at 9. Equitable and reliance interests were the linchpin of the decision of the Supreme Court of Virginia. That decision is correct and should be affirmed.

C. The availability of a pre-payment remedy forecloses the need for a post-payment remedy.

A unanimous Court said in *McKesson* that the provision of a pre-payment opportunity to object to a tax obviated any due process obligation to provide a post-payment remedy. Specifically, the Court stated:

> [I]f a State chooses not to secure payments under duress and instead offers a meaningful opportunity for taxpayers to withhold contested tax assessments and to challenge their validity in a predeprivation hearing, payments tendered may be deemed "voluntary." The availability of a predeprivation hearing constitutes a procedural safeguard against unlawful deprivations sufficient by itself to satisfy the Due Process Clause, and taxpayers cannot complain if they fail to avail themselves of this procedure. See *Mississippi Tax Comm'n, supra*, 412 U.S., at 368, n.11, 93 S. Ct. at 2187, n.11 ("[W]here

> voluntary payment [of a tax] is knowingly made pursuant to an illegal demand, recovery of that payment may be denied").

McKesson, 496 U.S. at 38 n.21.

Taxpayers in Virginia are entitled to challenge a tax assessment in a pre-payment procedure set forth in §§ 58.1-1821 and 58.1-1822 of the Virginia Code.[52] Virginia Regulation § 630-1-1820 provides that § 58.1-1821 "may be used to protest any and all issues connected with an assessment." While § 58.1-1821 does not require a formal hearing, a taxpayer may present his position both in writing and in person.[53] There can be no doubt that this procedure satisfies minimum conditions of due process for an adequate opportunity to object in advance to the payment of a tax. *Cf. Mathews v. Eldridge*, 424 U.S. 319 (1976); *Goldberg v. Kelly*, 397 U.S. 254 (1970).

Petitioners argued below that the remedy provided by § 58.1-1821 is meaningless because the Tax Commissioner is without authority to declare a statute unconstitutional. Petitioners' argument, nevertheless, misses the point. The issue is not whether a taxpayer must be provided a "declaration" of unconstitutionality. The issue is whether a taxpayer may *obtain relief* from the payment of the tax prior to payment. He clearly may obtain such relief in Virginia. Sections 58.1-1821 and 58.1-1822 grant the Tax Commissioner the authority to determine whether an applicant is "erroneously or improperly assessed with any tax." Virginia Tax Regulation § 630-1-1820, as noted above, provides that an application for correction under § 58.1-1821 before payment "may be used to

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[52] Sections 58.1-1821 and 58.1-1822 are set forth at SA 20-21. They first appeared in Virginia law in 1928. See Ch. 26, 1928 Va. Acts 223.

[53] *See* Va. Reg. § 630-1-1821 (Application under § 58.1-1821 "will be handled within the Department [of Taxation] in the manner best determined by the Commissioner to resolve the dispute, which may include submission of additional documents and memoranda, further audit, holding a conference with the taxpayer or the taking of testimony."). This regulation is quoted in relevant part at SA 21-22. It has been in effect since January 1, 1985, with retroactive effect pursuant to Va. Code § 58.1-203.

protest *any and all* issues connected with an assessment." The Commissioner clearly has the authority to withhold any action to collect an assessment if he deems a statute unconstitutional, and in fact has done so in specific cases. Section 58.1-1822 also authorizes the Commissioner to exonerate the taxpayer from the payment of a tax. Further, § 58.1-105 authorizes the Tax Commissioner to "compromise and settle doubtful or disputed claims for taxes."

Thus, under Virginia law, if the Tax Commissioner determines that a tax is of doubtful validity, he can refrain from collecting the tax, exonerate the taxpayer from the payment of the tax, or compromise or settle the tax liability. These options provide a taxpayer a full and complete remedy, all without paying the tax. Of equal importance, an objection in this form would put the Commonwealth on notice *before* the payment of the tax that its legality was being contested. It is not appropriate for Petitioners to sandbag the State by withholding their objection, paying the tax, and then attempting to obtain a refund after the money is spent.[54]

Petitioners had a clear, meaningful, pre-payment opportunity to challenge the validity of the tax of which they now complain. They chose not to avail themselves of this remedy. It follows under the language of *McKesson* that they must be considered to have paid the challenged taxes voluntarily. Most importantly, *McKesson* makes it clear that due process does not now require an additional post-payment refund remedy in order to provide Petitioners the relief they could have obtained in advance of paying the tax.

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[54] Petitioners might object to use of the word "sandbag" here. But they could do so only by claiming that they did not know before *Davis* that the tax was invalid. Such a claim, it will be noticed, is inconsistent with the entire thrust of their brief, which argues that *Davis* did not establish "new" law because the law had been clear for years. They cannot have it both ways.

CONCLUSION

The issue in this case is whether there is room in federal law for the operation of equitable considerations that protect reliance interests and settled expectations in situations where this Court decides a case that is a surprise to the legal community. By any measure, *Davis* was a surprise. It declared unconstitutional a tax that had been in effect for almost 50 years and that had been paid by hundreds of thousands of taxpayers during that period. The rare legal challenges to the tax in other states prior to *Davis* resulted in decisions upholding the tax. There had been no challenge in Virginia to the legality of the tax. The most directly relevant (indeed only) precedent cited by this Court in *Davis* had been decided 29 years earlier, yet not even that case had led those with a self-interest in avoiding the tax to question the legal basis for the taxes paid to the Commonwealth of Virginia at any point between 1960 and 1989. Nonetheless, Petitioners claim refunds for four tax years during which they too thought the taxes were valid, as evidenced by the fact that they raised no objections to paying the tax (even though, under Virginia law, they had a pre-payment opportunity for doing so). They claim refunds in an amount that is the equivalent of a 22% increase in the sales tax to be paid by every Virginian or a 13.6% surcharge on the income tax bills of every citizen of the Commonwealth. Whether this sum is to be exacted by increased taxes or decreased services, it is unfair to ask the citizens of the Commonwealth to pay what, from any honest assessment, these Petitioners never thought they were owed. And it is unfair to the citizens of some 16 other states to require them to fund sums in excess of $1.8 billion for similar claims.

Rationales may differ. There are, as has been demonstrated above, two independent theories upon which refunds can appropriately be denied to these Petitioners. One is that *Davis* is not to be retroactively applied. The other is that the state law of remedies may appropriately take equitable considerations into account. Both theories permit the withholding of retrospective relief in the case of unforeseen decisions that

break new ground, that undermine legitimate reliance interests, and that upset the settled expectations of the parties. Petitioners have benefitted and will continue to benefit from the full effect of *Davis* for the tax year in which the decision was made and for all subsequent tax years. There is no reason to rewrite history by restoring to them (at the expense of innocent citizens) moneys which they and the Commonwealth reasonably thought were lawfully taxed when paid. The decision below should be affirmed.

Respectfully submitted,

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SUPPLEMENTAL APPENDICES

APPENDIX A

FISCAL IMPACT OF DAVIS

State	Projected Refund Liability Under State Statute of Limitations Period[1]
Alabama	$ 20 million
Arizona	$339 million[2]
Arkansas	$ 45 million
Georgia	$100 million
Iowa	$ 45 million
Kansas	$ 91 million
Kentucky	$ 74 million
Mississippi	$ 35 million
Montana	$ 20 million
New York	$ 55 million
North Carolina	$140 million[3]
Oklahoma	$ 20 million[4]
South Carolina	$200 million
Utah	$120 million
Virginia	$467 million
Wisconsin	$ 70 million
TOTAL	$1.841 billion

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[1] Unless otherwise noted, all amounts may be regarded as accurate estimates of potential liability for tax principal and accrued interest. The information contained in this chart was provided by each State's Department of Revenue or Taxation through its legal counsel in response to a telephone survey conducted by the Virginia Office of the Attorney General during the week of July 13-17, 1992.

[2] The Arizona Tax Court has issued a refund order using a partial refund formula whereby the State's liability is substantially less than this figure. This partial refund order is on appeal.

[3] This represents the amount alleged by federal retirees to be at issue in presently pending class action litigation.

[4] This amount represents tax liability exclusive of any interest.

Excerpts from the Virginia Appropriations Act for 1992-94, 1992 Va. Acts of Assembly, Chap. 893, approved April 15, 1992.

(pp. 99-108)

§ 1-49. UNIVERSITY OF VIRGINIA

* * *

Grand Total for University of Virginia
Fund Sources: General $139,653,891.00

* * *

§ 1-50. VIRGINIA POLYTECHNIC INSTITUTE AND STATE UNIVERSITY (208)

* * *

Grand Total for Virginia Polytechnic Institute and State University
Fund Sources: General $162,387,379.00

§ 1-51. VIRGINIA COMMONWEALTH UNIVERSITY (236)

* * *

Grand Total for Virginia Commonwealth University
Fund Sources: General $124,737,522.00

[Total Annual General Fund Appropriation for Virginia's Three Largest State Universities ..... $426,778,792.00]

(p. 216)
Item 535

* * *

Grand Total, Department of Corrections
Operating Funds, FY 93 ..... $402,458,009.00

Excerpt from *Virginia Summary, Executive Budget of the Commonwealth of Virginia, 1992-94*, submitted to the Virginia General Assembly on January 8, 1992.

(p. A-4)

Overview

* * *

Principal Features of the 1992-94 Budget

The proposed budget calls on Virginians to modify their expectations of state government's role, to accept that it cannot be "business as usual" at the state level, and to help reposition Virginia for the future. The Governor's 1992-94 budget is a plan to permanently reduce and reshape the Commonwealth's spending to fit a forecast calling for low to modest revenue growth. The proposed budget has these characteristics:

- It makes permanent spending reductions in the budget through proposals to downsize, consolidate, and eliminate state programs. Many agency budgets have been reduced, on average, nearly 25 percent below original 1990-92 funding levels.

* * *

Excerpts from *Monthly Revenue Report*, prepared by the Office of the Comptroller and provided to Paul W. Timmereck, Secretary of Finance, on August 11, 1992.

* * *

	FY 93 ESTIMATE
Net Individual Income Tax	$3,488,400,000.00
Sales and Use Tax	$1,434,000,000.00
[State portion = 3% tax]	

* * *

Local Portion Sales and Use Tax	$ 478,000,000.00
[Local portion = 1% tax]	

* * *

Transportation Portion Sales and Use Tax	$ 240,477,000.00
[Transportation portion = ½% tax]	

APPENDIX B

SUPREME COURT OF VIRGINIA

Record No. 900770

HENRY HARPER, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

Record No. 900792

LAWRENCE E. LEWY, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

From the Circuit Court of the City of Alexandria
DONALD H. KENT, Judge

Present: Carrico, C.J., Compton, Stephenson, Whiting, Lacy, and Hassell, JJ., and Cochran, Retired Justice

OPINION BY JUSTICE ROSCOE B. STEPHENSON, JR.

March 1, 1991

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court of the United States declared that state taxation of pension income of retired federal government employees, while exempting from taxation pension income of retired state government employees, violated the doctrine of intergovernmental tax immunity embodied in the supremacy clause of the Constitution of the United States.

The Supreme Court, however, did not decide whether its decision in *Davis* had retrospective application.[1]

In these consolidated appeals, the appellants (collectively, Harper) are retired federal employees who receive either civil service retirement benefits or military retired pay. They filed suits in the trial court against Virginia Department of Taxation (the Commonwealth) in May 1989, seeking refunds, pursuant to Code § 58.1-1826, for state income taxes paid for tax years 1985, 1986, 1987, and 1988. After consolidating the several suits, the trial court ruled that *Davis* should be applied prospectively only and, therefore, that Harper was not entitled to the refunds. Harper appeals.

In this appeal, the principal issue is whether *Davis* should be applied only prospectively, thereby denying the refunds, or retroactively, thereby granting the refunds.

I

Whether a constitutional decision of the Supreme Court is applied retroactively is a matter of federal law. *American Trucking Associations, Inc. v. Smith*, ___ U.S. ___, ___, 110 S.Ct. 2323, 2330 (1990). In the civil context, retroactive application of such decisions is governed by the three-pronged test announced in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). *Smith*, ___ U.S. at ___, 110 S.Ct. at 2331, *see U.S. v. Johnson*, 457 U.S. 537, 563 (1982).

In *Smith*, the Supreme Court considered a state's taxing statute that previously had been declared unconstitutional under the commerce clause of the Federal Constitution.

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[1] The Supreme Court did not consider this issue because Michigan conceded that "to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." *Davis*, 489 U.S. at 817.

___ U.S. at ___, 110 S.Ct. at 2329. The Court denied the claimant's request for a refund of taxes paid prior to an earlier decision that invalidated the taxing statute. *Id.* at ___, 110 S.Ct. at 2334. In so doing, a plurality of the Court employed the three-pronged *Chevron* test and concluded that its earlier decision should not be applied retroactively. The Court found that its earlier decision invalidating an Arkansas highway tax, *American Trucking Assns., Inc. v. Scheiner,* 483 U.S. 266 (1987), established a "new principle of law" under the commerce clause. *Id.* at ___, 110 S.Ct. at 2332. Arkansas's legislature, therefore, was justified in relying upon existing precedent and had "good reason to suppose" the enactment of the tax would not violate the Federal Constitution. *Id.* at ___, 110 S.Ct. at 2333.

Harper contends, nonetheless, that "because the taxes at issue here . . . constitute[d] an 'unconstitutional deprivation,' . . . Virginia must provide 'backward-looking relief' to the refund claimants." Harper asserts that such relief is required by the holding in *McKesson Corp. v. Division of Alcoholic Beverages and Tobacco,* ___ U.S. ___, 110 S.Ct. 2238 (1990).

In *McKesson,* decided the same day as *Smith,* the Supreme Court held that a "clear and certain remedy," which could include refunds, was required to remedy Florida's unconstitutional liquor tax statute. ___ U.S. at ___, 110 S.Ct. at 2252. In so holding, the Court rejected Florida's contention that its taxing authority implemented the tax preference scheme " 'in good faith reliance on a presumptively valid statute.' " *Id.* at ___, 110 S.Ct. at 2254. In rejecting that contention, the Court stated that the challenged tax statute "reflected only cosmetic changes from the prior version of the tax scheme that itself was virtually identical to the Hawaii scheme invalidated" in *Bacchus Imports, Ltd. v. Dias,* 468 U.S. 263 (1984). Thus, the Court concluded, Florida "[could] hardly claim surprise" when its later statute was invalidated. *Id.* at ___, 110 S.Ct. at 2255.

In the present case, nothing in the record suggests that the Commonwealth acted other than in good faith reliance upon a presumptively valid taxing statute. We conclude, pursuant to *Smith,* that the three-pronged *Chevron* test must be employed to determine whether the *Davis* decision should be applied prospectively only.

A.

For a decision to be applied prospectively only, the first prong of the *Chevron* test requires that the decision "establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, . . . or by deciding an issue of first impression whose resolution was not clearly foreshadowed." 404 U.S. at 106. Satisfaction of this first prong usually has been stated as the "threshold test" for determining whether or not a decision should be applied prospectively only. *Johnson,* 457 U.S. at 550 n.12.

When *Davis* was decided, 23 states had statutes similar to the Michigan statute.[2] Virginia's statute had been in effect for almost half a century. *See* Acts 1942, c. 325. As far as the record shows, the federal pensioners had paid the tax without protest. Not a single federal pensioner had brought an action

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[2] *See* Ala. Code Sections 36-27-28 and 40-18-19 (Supp. 1988); Ariz. Rev. Stat. Ann. Section 43-1022 (Supp. 1988); Ark. Code Ann. Section 25-51-3206; Colo. Rev. Stat. Section 39-22-104(4)(f) and (g) (Supp. 1988); Ga. Code Ann. Section 48-7-27(a)(4)(A) (Supp. 1988); Iowa Code Ann. Section 97A.12 (West 1984); Kan. Stat. Ann. Section 74-4923(b) (1985); Ky. Rev. Stat. Ann. Section 16.690 (Michie/Bobbs-Merrill Supp. 1988); La. Rev. Stat. Ann. 47:44.1 (Supp. 1989); Mich. Comp. Laws Ann. Section 206.30 (1988); Miss. Code Ann. Section 25-11-129 (1972); Mo. Rev. Stat. Section 86.190 and 104.540 (1986); Mont. Code Ann. Section 15-30-111(2) (1987); N.M. Stat. Ann. Section 10-11-145 (1978); N.Y. Tax Law Section 612(c)(3) McKinney (1987); N.C. Gen. Stat. Section 135-9 (1988); Okla. Stat. tit. 68 § 2358 (1988); Ore. Rev. Stat. Section 316.680(1)(c) and (d) (1987); S.C. Code Section 12-7-435(a), (d), and (e) (Supp. 1988); Utah Code Ann. Section 49-1-608 (1989); Va. Code Section 58.1-322(C)(3) (Supp. 1988); W.Va. Code Section 11-21-12(c)(5) and (6) (Supp. 1988); Wis. Stat. Section 71.05(1)(a) (Supp. 1988).

during that period in a Virginia court seeking a refund of taxes on the basis of the intergovernment tax immunity doctrine. The absence of such litigation reasonably may be explained by examining the doctrine's origin and development.

The intergovernmental tax immunity doctrine had its genesis in *McCulloch v. Maryland,* 17 U.S. (4 Wheat.) 316 (1819). The doctrine was grounded on the proposition that "[s]tates have no power, by taxation or otherwise, to retard, impede, burden or in any other manner control, the operations [of the federal government]." *Id.* at 436.

The pre-*Davis* cases invalidating state taxing statutes were decided on the proposition that the tax had a foreseeable and direct effect on some operation of the federal government. *See, e.g., Memphis Bank & Trust Co. v. Garner,* 459 U.S. 392 (1983) (state tax that imposes greater burden on holders of federal obligations than on holders of similar state obligations impermissibly discriminates against securities issued by federal government); *Phillips Chemical Co. v. Dumas Indep. Sch. Dist.,* 361 U.S. 376 (1960) (state tax that imposes greater burden on lessees of federal property than on lessees of other exempt public property impermissibly discriminates against federal government). Indeed, *Davis* states that intergovernmental tax immunity is based on "the need to protect each sovereign's governmental operations from undue interference by the other." 489 U.S. at 814.

In the present case, it is difficult to discern how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation. Consequently, we conclude that the *Davis* decision established a new rule of a law by deciding an issue of first impression whose resolution was not clearly foreshadowed. Thus, the first prong of the *Chevron* test is satisfied.

B

The second *Chevron* prong requires a court to "weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation." 404 U.S. at 106-07. In applying this factor, we must determine whether the intergovernmental tax immunity doctrine will be retarded or furthered by retroactive application of the *Davis* decision.

The purpose of intergovernmental tax immunity is not to prevent legitimate state taxation. *See Smith,* ___ U.S. at ___, 110 S.Ct. at 2332. Virginia's taxing statute was legitimate until a new rule was announced in *Davis.* As soon as the General Assembly became aware of the *Davis* decision, it acted to correct the defects in its statute. *See* Acts 1989, Special Session II, c. 3. As a result, the purpose of the intergovernmental tax immunity doctrine already has been fully served, and applying *Davis* retroactively would do nothing either to retard or to further the doctrine's purpose. Therefore, the second prong of the *Chevron* test is satisfied.

C

The third prong of the *Chevron* test requires a court to "[weigh] the inequity imposed by retroactive application." 404 U.S. at 107. In weighing the equities, considerable deference must be accorded a state's reliance upon a statute that was presumptively valid. *See Lemon v. Kurtzman,* 411 U.S. 192 (1973). Indeed, "[i]t is well established that reliance interests weigh heavily in the shaping of an appropriate equitable remedy." *Id.* at 203. As Chief Justice Burger so aptly stated in *Lemon,* "statutory or even judge-made rules of law are hard facts on which people must rely in making decisions and in shaping their conduct. This fact of legal life underpins our modern decisions recognizing a doctrine of nonretroactivity." *Id.* at 199.

An important equitable consideration is the effect that retroactive application of a judicial decision may have on a state's financial stability. As the *Smith* plurality acknowledged, applying a judicial decision retroactively may "have potentially disruptive consequences for the State and its citizens. A refund, if required by state or federal law, could deplete the state treasury, thus threatening the State's current operations and future plans." ___ U.S. at ___, 110 S.Ct. at 2333.

In *Arizona Governing Committee v. Norris*, 463 U.S. 1073, 1105 (1983), the Supreme Court held that the State of Arizona's voluntary pension plan violated Title VII of the Civil Rights Act of 1964. The Court further held, however, that the state's liability would be prospective only. *Id.* The Court found that retroactive liability could cost the state hundreds of millions of dollars. As Justice Powell stated, "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Id.* at 1106-07. Because the illegality of Arizona's actions had not been declared until *Norris* was decided, Justice Powell further stated that "[t]here is no justification for this Court . . . to impose this magnitude of burden retroactively on the public." *Id.* at 1107.

In the present case, the record discloses that retroactive application of the *Davis* decision would give rise to a potential tax refund liability, inclusive of interest, of approximately $440,000,000. This liability would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits. The record contains affidavits of Commonwealth officials that support the conclusion that allowing the requested refunds would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services.

Harper contends, nonetheless, that "it is simply more equitable to place the financial consequences . . . upon the

government (and thus the whole body of taxpayers) than upon a small subclass of taxpayers who had unconstitutionally been forced to pay the tax in the first instance." Thus, Harper asserts, "taxpayers who have been paying more than their lawful share of taxes should be reimbursed by those who have paid less."

The Commonwealth counters by pointing out that "hundreds of thousands of other Virginia taxpayers have paid taxes on their private pension income but have no claim for monetary relief." The Commonwealth further asserts that "over 2.5 million Virginians annually have paid their 'fair share' of taxes while only some sixty thousand state and local retirees were excluded from pension income taxation."

The record supports the Commonwealth's assertions, and we conclude that, on balance, the equities weigh heavily in favor of the Commonwealth. Consequently, the third prong of the *Chevron* test is satisfied.

Accordingly, we hold that, under the *Chevron* test, the *Davis* decision is not to be applied retroactively. *Accord Bass v. State*, 395 S.E.2d 171 (S.C. 1990).

II

Harper contends, nonetheless, that the refunds are due as a matter of state law. He relies upon Code §§ 58.1-1825 and -1826. Code § 58.1-1825 provides that "[a]ny person assessed with any tax administered by the Department of Taxation and aggrieved by any such assessment may . . . within three years from the date such assessment is made, apply to a circuit court for relief." Code § 58.1-1826 provides, in pertinent part, as follows:

> If the court is satisfied that the applicant is erroneously or improperly assessed with any taxes, the court may order that the assessment be corrected. If the assessment exceeds the proper amount, the court may order that the applicant be

> exonerated from the payment of so much as is erroneously or improperly charged, if not already paid and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the court shall order that the applicant pay the proper taxes and to this end the court shall be clothed with all the powers and duties of the authority which made the assessment complained of as of the time when such assessment was made and all the powers and duties conferred by law upon such authority between the time such assessment was made and the time such application is heard. The court may order that any amount which has been improperly collected be refunded to such applicant.

Harper asserts that, even if the *Davis* decision applies prospectively only, the federal retirees are entitled to refunds under Code § 58.1-1826. Harper argues that, because the assessments are unconstitutional, they also are "erroneous or improper."

We reject this argument. We hold that, because the *Davis* decision is not to be applied retroactively, the pre-*Davis* assessments were neither erroneous nor improper within the meaning of Code § 58.1-1826.

Harper's state-law contention also fails for another reason. We previously have held that this Court's ruling declaring a taxing scheme unconstitutional is to be applied prospectively only. *Perkins v. Albermarle County*, 214 Va. 240, 198 S.E.2d 626, *aff'd and modified on rehearing*, 214 Va. 416, 200 S.E.2d 566 (1973).[3] We adhere to our holding in

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[3] The case of *Capehart v. City of Chesapeake*, No. 5459 (Circuit Court, City of Chesapeake, decided Oct. 16, 1974), followed *Perkins*. In *Capehart*, more than one hundred taxpayers in the City of Chesapeake, who had been subjected to the same practice that was invalidated in *Perkins*, brought suit in circuit court seeking, among other things, refunds of the taxes "illegally and unconstitutionally assessed." The City demurred, citing *Perkins*. The circuit court sustained the demurrer, being of opinion that the case was controlled by *Perkins*. We denied Capehart's petition for appeal. 215 Va. xlvii, and Capehart's petition for certiorari raising due process grounds was denied by the Supreme Court, 423 U.S. 875 (1975).

Perkins. In so doing, we follow the criteria stated in *Fountain v. Fountain*, 214 Va. 347, 348, 200 S.E.2d 513, 514 (1973), *cert. denied*, 416 U.S. 939 (1974), that "consideration should be given to the purpose of the new rule, the extent of the reliance on the old rule, and the effect on the administration of justice of a retroactive application of the new rule." *See also Quick v. Harris*, 214 Va. 632, 634, 202 S.E.2d 869, 871 (1974), *cert. denied*, 420 U.S. 907 (1975).

III

Finally, Harper contends that "even if *Davis* were applied prospectively only, refunds for 1988 taxes would nonetheless be due, for they were not assessed, and in many cases were not paid, until *after Davis* was decided." (Emphasis in original.) *Davis* was decided on March 28, 1989. The last day for filing individual income tax returns for the 1988 taxable year was May 1, 1989. Harper claims that the last day for filing income tax returns is the date on which income taxes are assessed for the preceding year.[4] We do not agree.

Income taxes are "imposed on the Virginia taxable income *for each taxable year* of every individual." Code § 58.1-320. (Emphasis added.) The taxable year ended on December 31, 1988, almost three months before *Davis* was decided. When the year ended, the 1988 tax was fixed and ascertainable. Only payment of the tax was delayed until May 1, 1989. Code § 58.1-341.

The Supreme Court rejected a similar contention in *Smith*. The Court reasoned that tax liability depends upon the

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[4] Harper's reliance upon Code § 58.1-1820 is misplaced. Section 58.1-1820 defines "assessment" as that term is used in Article 2 of Chapter 18, which establishes limitation periods for various forms of relief. Individual income tax liability is established in Article 2 of Chapter 3.

" 'occurrence of the taxed transaction or the enjoyment of the taxed benefit, not the remittance of the tax.' " *Smith*, ___ U.S. at ___, 110 S.Ct. at 2335. As Justice O'Connor observed,

> [a] contrary rule would give States a perverse incentive to collect taxes far in advance of the occurrence of the taxable transaction. It would also penalize States that do not immediately collect taxes, but nevertheless plan their operations on the assumption that they will ultimately collect taxes that have accrued.

Id. at 2336.[5]

In sum, we hold that, (1) under the *Chevron* test, the *Davis* decision is not to be applied retroactively, (2) state law does not require tax refunds, but to the contrary, grants prospective-only application to decisions that invalidate a taxing scheme, and (3) our denial of refunds includes taxes due for the tax year 1988. Accordingly, the trial court's judgment will be affirmed.

Record No. 900770 – *Affirmed.*

Record No. 900792 – *Affirmed.*

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[5] For the same reason, we reject the contention in *Lewy* (Record No. 900792) that the trial court erred in denying injunctive relief that would have barred the Commonwealth from filing any action to collect taxes from those who, after the *Davis* decision, had refused to pay the 1988 taxes.

SUPREME COURT OF VIRGINIA

Record No. 900770

Present: All the Justices

HENRY HARPER, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

Record No. 900792

LAWRENCE E. LEWY, *et al.*

v.

VIRGINIA DEPARTMENT OF TAXATION

On Remand from the Supreme Court of the United States

OPINION BY JUSTICE ROSCOE B. STEPHENSON, JR.

November 8, 1991

These cases are before us again, having been remanded for our further consideration from the Supreme Court of the United States, ___ U.S. ___, 111 S.Ct. 2883 (1991).

In *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), the Supreme Court decided that state taxation of pension income of retired federal government employees, while exempting from taxation pension income of retired state government employees, violated the doctrine of intergovernmental tax immunity embodied in the supremacy clause of the Constitution of the United States. The appellants in the present case (collectively, Harper) filed suits for tax refunds

pursuant to Code § 58.1-1826, claiming that the Commonwealth unconstitutionally taxed their federal retirement incomes and that state law requires the refund of those taxes collected during the three-year period preceding the *Davis* decision.

On March 1, 1991, we held that the *Davis* decision is not to be applied retroactively, and accordingly, Harper was not entitled to a refund. *Harper v. Virginia Department of Taxation*, 241 Va. 232, 401 S.E.2d 868 (1991). In so doing, we applied the three-pronged test announced in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). On June 28, 1991, the Supreme Court vacated our March 1, 1991 decision and remanded these cases to us "for further consideration in light of *James B. Beam Distilling Co. v. Georgia*, 501 U.S. ___, 111 S.Ct. 2439 (1991)."

The Georgia taxing statute at issue in *Beam* imposed an excise tax on imported alcohol and distilled spirits at a rate double that imposed on alcohol and distilled spirits manufactured from products grown in Georgia. After the decision in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), in which the Supreme Court held that a Hawaii taxing statute that distinguished between alcoholic products imported from other states and locally manufactured alcoholic products violated the commerce clause of the Federal Constitution, James B. Beam Distilling Company, a Delaware corporation and Kentucky bourbon manufacturer, brought suit in a Georgia trial court, claiming that the Georgia statute likewise was violative of the commerce clause. The distilling company sought a full refund of the taxes paid for the taxable years 1982, 1983, and 1984. Relying upon *Bacchus*, the Supreme Court of Georgia held that the Georgia statute was unconstitutional. The Georgia court, however, refused to apply its ruling retroactively, thereby denying the requested refund. In so doing, the court applied the *Chevron Oil* test. *Beam*, 501 U.S. at ___, 111 S.Ct. at 2442.

The question presented in *Beam* was whether the new rule of law announced in *Bacchus* "should apply retroactively to claims arising on facts antedating that decision." *Id.* at ___, 111 S.Ct. at 2441. The Supreme Court reversed the Georgia court's judgment and remanded the case for further proceedings. *Id.* at ___, 111 S.Ct. at 2448.

The plurality opinion in *Beam* was authored by Justice Souter and joined by Justice Stevens. Justice Souter concluded that *Beam* involved retroactivity as a choice-of-law issue rather than as a remedial issue. *Id.* at ___, 111 S.Ct. at 2443. Justice Souter then set forth three possible solutions to the choice-of-law problem. First, a decision announcing a new rule of law may be made fully retroactive by applying the new rule both to the parties before the court and to all others by and against whom claims are made without regard to when such claims arise. Second, such a decision may be made purely prospective by applying the new rule of law only to cases arising on facts postdating the pronouncement. Third, the new rule could be applied to the parties before the court and the old rule could be applied to all other cases arising on facts predating the decision. *Id.* at ___, 111 S.Ct. at 2443-44. This third possibility, called "modified, or selective, prospectivity," was abandoned in the criminal context in *Griffith v. Kentucky*, 479 U.S. 314, 328 (1987). *Beam*, 501 U.S. at ___, 111 S.Ct. at 2444-45. Justice Souter rejects this concept in the civil context. *Id.* at ___, 111 S.Ct. at 2447.

After concluding that the Supreme Court in *Bacchus* had applied its new rule to the litigants there before the court, Justice Souter stated the following:

> Thus, the question is whether it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so. We hold that it is, principles of equality and *stare decisis* here prevailing over any claim based on a *Chevron Oil* analysis.

Id. at ___, 111 S.Ct. at 2446.

The present case, however, is distinguishable from *Beam*. Although the Supreme Court in *Bacchus* applied its rule retroactively to the litigants in that case, the Court made no such ruling in *Davis*. Indeed, the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated. 489 U.S. at 817.

In order for a case to be precedent for another case, the court in the first case must have decided the issue presented in the second case. *United States v. L.A. Tucker Truck Lines*, 344 U.S. 33, 37-38 (1952); *United States v. Mitchell*, 271 U.S. 9, 14 (1926); *Webster v. Fall*, 266 U.S. 507, 511 (1925). Therefore, because the retroactivity issue was not decided in *Davis*, we are not foreclosed by precedent from applying the three-pronged *Chevron Oil* test in deciding the retroactivity issue in the present case.* *Accord Swanson v. North Carolina*, 329 N.C. 576, 586, 407 S.E.2d 791, 796 (1991).

Moreover, as Justice Souter stated in Part IV of the plurality opinion, the grounds for the *Beam* decision are narrow. 501 U.S. at ___, 111 S.Ct. at 2448. "[The grounds] are confined entirely to an issue of choice of law: when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." *Id.* at ___, 111 S.Ct. at 2448.

Beam is important not only for what it decided but also for what it did not decide. As Justice Souter wrote:

> We do not speculate as to the bounds or propriety of pure prospectivity.

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* Furthermore, we do not read *Beam* as rejecting the *Chevron Oil* test. Four Justices clearly embrace the test's application in determining retroactivity. Two Justices reject the test, but only in its application to the choice-of-law issue. Only three Justices completely reject the test.

> Nor do we speculate about the remedy that may be appropriate in this case; remedial issues were neither considered below nor argued to this Court- . . . . Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided. . . .

Id. at ___, 111 S.Ct. at 2448 (citations omitted).

Consequently, having reconsidered our March 1, 1991 decision in light of *Beam*, we conclude that nothing articulated in *Beam* requires a result different from that reached in our prior decision. Accordingly, we reaffirm our prior decision in all respects.

Affirmed.

APPENDIX C

Report of the

House Finance Retirement Subcommittee

To

The Governor and the General Assembly of Virginia

Richmond, Virginia

December, 1982

To: Honorable Charles S. Robb, Governor of Virginia

and

The General Assembly of Virginia

CHARACTERISTICS OF SELECTED VIRGINIA RETIREES

Category	Average Retirement	Number
Federal Civil Service	$ 15,416	74,932
Military	$ 14,454 ($ 21,406 officers) ($ 9,494 enlisted)	76,880
VSRS (state employees)	$ 4,020	13,905

EXCERPTS FROM THE VIRGINIA INCOME TAX LAW AND REGULATIONS

§ 58.1-1821. Application to Tax Commissioner for correction. – Any person assessed with any tax administered by the Department of Taxation may, within ninety days from the date of such assessment, apply for relief to the Tax Commissioner. Such application shall be in the form prescribed by the

Department, and shall fully set forth the grounds upon which the taxpayer relies and all facts relevant to the taxpayer's contention. The Tax Commissioner may also require such additional information, testimony or documentary evidence as he deems necessary to a fair determination of the application.

On receipt of a notice of intent to file under this section, the Tax Commissioner shall refrain from collecting the tax until the time for filing hereunder has expired, unless he determines that collection is in jeopardy.

Any person whose tax assessment has been improperly collected by the Department may apply hereunder to assert a claim that any amount so collected was exempt from process.

§ 58.1-1822. Action of Tax Commissioner on application for correction. – If the Tax Commissioner is satisfied, by evidence submitted to him or otherwise, that an applicant is erroneously or improperly assessed with any tax administered by the Department of Taxation, the Tax Commissioner may order that such assessment be corrected. If the assessment exceeds the proper amount, the Tax Commissioner shall order that the applicant be exonerated from the payment of so much as is erroneously or improperly charged, if not already paid into the state treasury, and, if paid, that it be refunded to him. If the assessment is less than the proper amount, the Tax Commissioner shall order that the applicant pay the proper taxes. He shall refund to the taxpayer any exempt funds which have been improperly collected. The Tax Commissioner shall refrain from collecting a contested assessment until he has made a final determination under this section unless he determines that collection is in jeopardy.

Va. Reg. § 630-1-1820. In general; definitions.

A. Types of remedies. Article 2, Chapter 18, Code of Virginia 1950, as amended, provides several administrative and judicial remedies for taxpayers who believe an assessment to be erroneous. In addition, Va. Code § 58.1-105

authorizes the Commissioner to accept an offer in compromise in certain circumstances. The various remedies available for taxes administered by the department may be summarized as follows:

1. Offer in compromise under § 58.1-105, which may be used to waive or compromise a penalty for good cause or to compromise a tax based on a doubtful or disputed claim or a liability of doubtful collectibility.

2. Application for correction for an erroneous assessment under § 58.1-1821 before payment of the assessment, which may be used to protest any or all issues connected with an assessment.

3. Amended return claiming a refund under § 58.1-1823, which may be used to amend a return based upon new or newly discovered facts such as errors discovered in the original return or a change in federal taxable income.

4. Protective claim under § 58.1-1824 after payment of the assessment, which may be used to protest any or all issues connected with an assessment and, in certain circumstances, may extend the time in which taxpayer may apply to a court.

5. If the above administrative remedies are not satisfactory to the taxpayer, the assessment may be paid and an application to a court made under § 58.1-1825.

B. Exhaustion of administrative remedies. Although not required by law, taxpayers are encouraged to exhaust their administrative remedies before resorting to litigation. Administrative reviews remain confidential pursuant to §§ 58.1-3 and 58.1-204. Even if a dispute cannot be resolved administratively, the issues in dispute may be significantly narrowed allowing expeditious court review.

* * *

Va. Reg. § 630-1-1821. Application for correction (before payment).

A. Application.

1. A taxpayer may apply to the Commissioner for correction of an erroneous assessment before payment of the assessment. . . . The application will be handled within the Department in the manner best determined by the Commissioner to resolve the dispute, which may include submission of additional documents and memoranda, further audit, holding a conference with the taxpayer or the taking of testimony. . . .

. . .

B. Collection and billing. When an application has been duly filed the Commissioner will not take any action to collect the tax, penalty and interest assessed unless he determines that collection is in jeopardy. . . .

Supreme Court, U.S.
FILED
OCT 14 1992
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No. 91-794

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION

On Writ of Certiorari to the Supreme Court of Virginia

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On Writ of Certiorari to the Supreme Court of Virginia

REPLY BRIEF

The Department of Taxation labors to support the retroactivity decision below, but on each front its arguments fall well short. Similarly, its argument that petitioners are not entitled to relief even upon retroactive application of *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), is without merit. Petitioners are entitled to refunds of the taxes unconstitutionally imposed on their federal pensions, either under Virginia's refund statute or directly under the Fourteenth Amendment. For the reasons stated in petitioners' opening brief, and for the reasons stated herein, the decision of the court below must be reversed with instructions to grant petitioners' refunds.

I. THE COURT BELOW ERRED IN CHOOSING TO IGNORE 4 U.S.C. § 111 AND *DAVIS*

In petitioners' opening brief, we asserted that the court below erred in choosing not to apply 4 U.S.C. § 111 and

Davis to resolve this controversy. We argued that *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), requires that *Davis* be applied retroactively; that this Court has never relied on *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), or any other form of nonretroactive decisionmaking to sanction departure from an unambiguous congressional mandate; and that even if purely prospective decisionmaking is ever appropriate, *Davis* must be applied retroactively. The Department of Taxation, and the states and other entities that have filed briefs in its support, focus their arguments principally on this last point. For the reasons stated here and in our opening brief, however, this Court need not even reach the issue of the applicability of *Chevron* to reverse the court below. Yet even if the Court were to reach the merits of the lower court's *Chevron* analysis, the decision below nonetheless must be reversed.

A. *Beam* Requires That *Davis* Be Applied Retroactively

The Department of Taxation acknowledges that the central hold in *Beam* is that once this Court has applied its ruling to the parties in one case, all other courts must apply that ruling to litigants before them. *See* Res. Br. at 4. Similarly, it acknowledges that the Court applied its holding to the litigants in *Davis* (Res. Br. at 5) and did not specificalffily reserve the question of retroactivity. Res. Br. at 6 n.3. Nonetheless, arguing essentially that this Court could not have meant what it said in *Beam* (Res. Br. at 5), it suggests that the issue of the retroactivity of *Davis* remains open. The Department of Taxation's wishes notwithstanding, *Beam* is dispositive of this appeal.

Although *Beam* produced six separate opinions, on at least two points the Court was unanimous. *First*, no opinion questioned Justice Souter's repeated observation that full retroactivity is "overwhelmingly the norm" in civil litigation, 111 S. Ct. at 2443, so much so that it "goes without saying." 111 S. Ct. at 2445. *See e.g.*, 111 S. Ct. at 2451 (O'Connor, J., dissenting) ("the usual course in cases before this Court is to apply the rule of

law announced to the parties in the case."). *Second*, the Court fully agreed that "[b]ecause the *Bacchus*[1] opinion did not reserve the question whether its holding should be applied to the parties before it, . . . it is properly understood to have followed the normal rule of retroactive application in civil cases." 111 S. Ct. at 2445. *See* 111 S. Ct. at 2448 (White, J., concurring in the judgment) ("*Bacchus* may reasonably be read as extending the benefits of the judgment in that case to the appellant Bacchus Imports.") (citation omitted); 111 S. Ct. at 2451 (O'Connor, J., dissenting) ("the most reasonable reading of [*Bacchus*'] silence is that the Court followed its customary practice."). *See also Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S. Ct. 2773, 2787-88 (1991) (O'Connor, J., dissenting) (recognizing that the majority's failure to address the issue of retroactivity translated to full retroactive application of the decision).

The Department of Taxation suggests that because there was only one sentence in *Davis* dealing with the issue of remedy, this Court in *Davis* did not resolve the issue of retroactivity. Yet as *Beam* and *Lampf* make clear, *Davis* would command retroactive effect even if there had been no mention of remedy. Undeniably, the Court in *Davis* did not reserve the question of its retroactivity. Thus, the Court was at most "silent" on the issue of retroactivity. That being so, even setting "[q]uestions of remedy aside," *Davis* "is fairly read to hold as a choice of law that its rule should apply retroactively to the litigants before the Court." 111 S. Ct. at 2445.

Moreover, the Department of Taxation is simply wrong in asserting that Michigan's concession somehow dilutes the force of the Court's conclusion that Mr. Davis was entitled to a remedy. Had Michigan not conceded that its refund statute provided an adequate remedy (such that the Court need not retroactively impose a tax on the favored class (No. 87-1020, Brief for Appellee at 63)),

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[1] *Bacchus Imports, Ltd v. Dias*, 468 U.S. 264 (1984).

this Court would have done just what it did in *Bacchus*, *Williams v. Vermont*, 472 U.S. 14, 28 (1985), and *Exxon Corp. v. Eggerton*, 462 U.S. 176, 196-97 (1983): remand for consideration of remedial issues.

The Department of Taxation complains that it would be unfair to hold it and others to the concession made by Michigan. Res. Br. at 6. This complaint is unfounded, for it confuses two separate issues: 1) entitlement to *a* remedy; and 2) determination of the proper remedy in a particular case. To be sure, Michigan's concession may have driven the determination that a refund was the appropriate remedy, but it did not drive the determination that a remedy was required. It is the determination that a remedy is required, not the particular form of relief granted, that is binding on all other courts as a matter of equality and *stare decisis*.[2]

Thus, the Department of Taxation is left to argue that this Court could not possibly have meant what it said in *Beam*. *See* Res. Br. at 6-7 n.3. According to the Department of Taxation, this Court must have meant in *Beam* that principles of equality and *stare decisis* prevail only in the rare case where the issue of retroactivity was briefed and argued in this Court. Of course this is not what *Beam* says, and *Beam*'s rejection of modified prospectivity does not admit of any exceptions. Moreover, this Court was well aware of the *Davis* refund litigation when it decided *Beam*, *see* Brief *Amici Curiae* of the

[2] *Amici Curiae* National Governors' Ass'n, *et al.* contend that *Davis* merely accepted Michigan's concession that a refund was required as a matter of state law and thus *Davis* did not reach the federal question of retroactive application of the decision. *Amici* Br. at 11. *Davis*' citation to *Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239 (1931), however, independently supports the conclusion that refunds were the required remedy. In any event, irrespective of whether the refund was a product of state law (*i.e.*, Michigan's concession) or federal law (*i.e.*, *Iowa-Des Moines Bank v. Bennett*), the question of remedy would not have arisen unless this Court had determined to apply its holding to the parties before it. It is this determination, that a remedy is required as a matter of federal law, that is dispositive for purposes of *Beam*.

States of Alabama, *et al.*, No. 89-680 at 6-11; so too was it aware when it decided *Davis* that twenty-two other states imposed a similar discriminatory tax on federal retirees. *See* 489 U.S. at 822 n.3 (Stevens, J. dissenting).

Lastly, the Department of Taxation argues that if this Court did mean what it said in *Beam*, then because *Davis* was decided before *Beam*, *Beam* itself should not apply retroactively. To this, is should suffice to say that even though *Bacchus* was decided before *Beam*, *Beam* was nonetheless applied retroactively. In any event, given *Beam*'s recognition that there is no precedent for modified prospectivity in the civil arena, the Department of Taxation can hardly contend that *Beam* established a new principle of law.

B. This Court Cannot Change The Effective Date Of A Congressional Enactment

We stressed in our opening brief that the retroactivity question posed in this case is unique: here the Court is not being asked simply to defer the implementation of one of its decisions; rather it is being asked to declare that an Act of Congress became effective over fifty years after it was lawfully enacted. Yet this Court does not sit as a superlegislature, empowered to redraft congressional enactments to comport with its own notions of wisdom or equity. Rather, its role is to discern the legislative intent, and, having done so, to enforce Congress' will.

The totality of the response to this argument is two footnotes, one in the Department of Taxation's brief (Res. Br. at 11-12 n.10), and one in the Brief *Amici Curiae* of the National Governors' Ass'n, *et al.*, at 15-16 n.7. The Department of Taxation contends that in *Chevron* this Court delayed the implementation of a federal statute (43 U.S.C. § 133(a)(2)). Additionally, it cites *Florida v. Long*, 487 U.S. 283 (1988), and *Northern Pipeline Const. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50 (1982), to refute petitioners' point. The National Governors' Ass'n adds *Chicot County Drainage District v. Baxter State Bank*, 308 U.S. 371, 384 (1940), to this list.

These authorities hardly support the proposition, necessary to sustain the decision below, that this Court may utilize nonretroactivity to supervene the expressed will of Congress. In *Chevron* this Court held that "the *Louisiana* one-year statute of limitations should not be applied retroactively." 404 U.S. at 107 (emphasis added). The Court did not say that 43 U.S.C. § 133(a)(2) only became effective on the date it decided *Chevron*; rather, it held that because litigants relied on prior circuit authority allowing a longer period of limitations, equity demanded that the shorter Louisiana statute of limitations be tolled. *Id.* Tolling of a statute of limitations is not judicial defiance of that statute; to the contrary, even in suits against the United States, allowing tolling is "likely to be a realistic assessment of legislative intent." *Irwin v. Veterans Admin.*, 111 S. Ct. 453, 457 (1991).

Similarly, neither *Florida v. Long*, nor any other Title VII pension case, represents an instance when this Court has deviated from a congressional mandate in the name of nonretroactivity. Rather, as we stated in our opening brief, Pet. Br. at 16-17, these are cases in which the Court's nonretroactive relief was anchored in Title VII's specific remedial provisions. *See* 42 U.S.C. § 2000e-5(g) (authorizing courts to order such "equitable relief as the court deems appropriate."). *Northern Pipeline Const. Co.* is a case in which this Court stayed its judgment *invalidating* a statute to enable Congress to enact another provision; rather than standing for defiance of a statute, this case demonstrates the deference this Court accords Congress in fulfilling its constitutional function. Finally, *Chicot County Drainage District* cannot be cited as an example of this Court utilizing nonretroactivity to supervene an Act of Congress. Indeed, *Chicot County Drainage District*, which also involved the invalidation of a statute, is a *res judicata* case, not a retroactivity case. *See* 308 U.S. at 378 (holding that final judgment obtained under a statute subsequently declared unconstitutional is nonetheless preclusive).

What the Department of Taxation asks this Court to do in this case is not remotely similar to anything it has

ever done before. Congress passed the Public Salary Tax Act in 1939 and therein waived the United States' immunity for nondiscriminatory state taxation of "compensation, *received after December 31, 1938*, for personal services as an officer or employee of the United States." 53 Stat. 575 (emphasis added). In 1989, this Court held that Congress meant just what it said: states cannot tax compensation for personal services as an employee of the United States, including retirement pay, if they do not tax the same compensation of state employees. *Davis*, 489 U.S. at 815. The Department of Taxation now asks this Court to amend the Public Salary Tax Act to read "compensation, received after December 31, *1988*." The Department of Taxation does not ask this Court to toll a statute of limitations, or stay a judgment invalidating a congressional enactment: it asks this Court to change a deliberate and unambiguously enacted provision of law. Plainly, the Court has no such license.

C. *Chevron* Analysis, Even If Apt, Would Yield Retroactive Application Of *Davis*

For the reasons stated above (as amplified in our opening brief (Pet. Br. at 6-18)), this Court need not even reach the issue of the continued viability or application of *Chevron*. But even to entertain the merits of the decision below, the Court would first have to definitively establish "the bounds [and] propriety of pure prospectivity." *Beam*, 111 S. Ct. at 2448.

To our argument that *Chevron* could not reach a case such as this, the Department of Taxation lamely asserts "[s]urely there is room in legal doctrine" to consider its "equitable" plea in determining the legality of the conduct at issue here. Res. Br. at 11. Its equitable claim, however, is only that it had been ignorant of the law (Res. Br. at 32), and that this ignorance should not cost it money. By its ignorance, the Department of Taxation has taken uncounted billions of dollars from elderly, infirm and often impoverished pensioners; it is the height of arrogance and insensitivity for the Department of

Taxation now to argue that it would be inequitable for it to return a mere fraction of its ill-gotten gains. Why there must be room in legal doctrine for this type of self-serving argument is not apparent.

This Court's recent cases show a marked reluctance to engage in nonretroactive decisionmaking. Other than in Title VII pension cases (and by the narrowest of margins in *American Trucking Ass'ns v. Smith*, 496 U.S. 167 (1990)), in no other civil case over the past decade has this Court applied its holding nonretroactively. Indeed, even where this Court has avowedly established a new principle of law, it refused to apply its decision nonretroactively. *See Rodriguez de Quijas v. Shearson/American Express*, 490 U.S. 477, 485-86 (1989). As we stated in our opening brief, if *Chevron* analysis may ever be used as a choice of law vehicle, then it may only be used in cases involving overturning of established precedent or revolutionary resolution of questions of first impression. Pet. Br. at 21-23. Under no set of circumstances could *Davis* satisfy this test.

1. Davis *did not establish a "new principle of law"*

The Department of Taxation strives vainly to identify two "new" principles of law supposedly enunciated by *Davis*. Its arguments on this score are specious: in no sense did *Davis* represent "an avulsive change which caused the current of the law thereafter to flow between new banks." *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481, 499 (1968). At the threshold, however, the Department of Taxation's arguments on this score are irrelevant.

Specifically, the Department of Taxation contends that *Davis* announced a new principle of law in holding that federal retirement benefits are compensation (Res. Br. at 16) and in holding, essentially, that Justice Stevens' dissent is not the law. Res. Br. at 18. The central premise of nonretroactivity jurisprudence is reliance; *i.e.*, reconciliation of "the constitutional interests reflected in a new rule of law with reliance interests founded upon the old."

Lemon v. Kurtzman, 411 U.S. 192, 198 (1973). The Department of Taxation does not claim, however, that it relied on the "old" law supposedly supplanted by *Davis*. Rather, it admits that it was wholly ignorant of 4 U.S.C. § 111 and its application to federal annuities (Res. Br. at 32), and it repeatedly and inappropriately castigates petitioners for not having educated it. Thus, even if *Davis* had established a new principle of law, that would have been pure fortuity as far as the Department of Taxation is concerned, for it relied solely upon its own ignorance, and not any principles of law supposedly discarded by *Davis*, in collecting the taxes at issue here.

That the Department of Taxation did not foresee *Davis* is apparent. But the principles underlying *Davis* were easy enough to discern, had it looked. It never looked, however, and its only excuse for this failure is that petitioners never asked it to.[3] The Department of Taxation suggests that "this Court is unlikely ever to see a stronger case of reliance and settled expectations," Res. Br. at 11 n.10, but reliance and settled expectation borne solely of ignorance are hardly the type sufficient to justify nonretroactive decisionmaking.

Moreover, the Department of Taxation's insistent reference to the lack of a prior legal challenge provides it no solace, for this too is irrelevant. No matter when the challenge was brought, it still would have sought four years' back taxes. Thus, had petitioners brought suit sooner, the only difference would be that the total amount of unconstitutional taxes the Department of Taxation could shelter behind its statute of limitations would be

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[3] The Department of Taxation acknowledges that federal retirees voiced their complaints about the inequity of Virginia's discriminatory tax to the legislature. Res. Br. at 39. Certainly at that time the Department of Taxation should have inquired into the legal validity of its brazenly discriminatory tax. Had it done so, in light of *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939), and *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376 (1960), it would have had to have concluded that its tax was of dubious validity, at best.

reduced. If anything, the fact that the Department of Taxation improperly profited for fifty years .from its violation of 4 U.S.C. § 111 adds further weight to petitioners' claim for the refunds of the last few years of the unconstitutional taxation.

Similarly flawed is the Department of Taxation's suggestion that the fact that its unconstitutional statute stood unchallenged for fifty years "is compelling—indeed conclusive evidence—that *Davis* established a new principle of law." Res. Br. at 13. If so, then *Bacchus* must too have established a new principle of law, for the statute at issue in *Beam* had been on the books for over fifty years and indeed had been upheld by Georgia's Supreme Court in 1939. *Beam*, 111 S. Ct. at 2455. So too *Ashland Oil Inc. v. Caryl*, 497 U.S. 916 (1990), must have been wrongly decided, for the statute at issue there had been in force for over fifty years and, like Georgia's statute (but unlike Virginia's), had been upheld by the state's highest court. *See Columbia Gas Transmission Corp. v. Rose*, 459 U.S. 807 (1982). Any legitimate repose interests the Department of Taxation might have are adequately protected by its statute of limitations, which limits its exposure to four tax years.[4]

In any event, the reasons this case did not come forward sooner have much more to do with economics than law. While the Department of Taxation queries "Where were petitioners' tax lawyers?", Res. Br. at 12, it should realize that tax lawyers are luxuries few federal retirees need or can afford. Indeed, it is significant that the cost of print-

[4] The Department of Taxation and certain *amici* suggest that a refund to petitioners would be a windfall. As petitioners understand it, the argument goes "because petitioners did not know the taxes were unconstitutional when they paid them, they do not deserve to get them back." This would seem to be an argument only a taxing authority could make. By this definition, because Virginia does not require payment under protest as a prerequisite to obtaining a tax refund (Res. Br. at 40, n.48), and because the vast majority of taxpayers do not knowingly overpay their taxes, virtually every tax refund Virginia pays would equally qualify as a "windfall."

ing the Joint Appendix in this case alone exceeds the amount of refund any petitioner could expect to realize. Given these gross economic disparities, the truly remarkable fact is that *Davis* was brought at all, not that it was not brought sooner.

In its best light, the Department of Taxation's argument is that 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine are obscure. But obscurity plus time cannot equal justifiable reliance. The question is not *did* the Department of Taxation see *Davis* coming; the question is *could it* have seen it coming. And, had it looked, either in 1942 when Virginia enacted the statute, or in 1985, the earliest tax year in dispute here, it would have discovered that its tax was in serious jeopardy.

Federal retirement benefits are, and have always been, compensation. The Department of Taxation contends that *Davis* created a new principle of law in holding that federal retirement benefits are "compensation for personal services as an employee" within the meaning of 4 U.S.C. § 111. To be sure, this Court had never faced the question, prior to *Davis*, whether federal annuities are compensation within the meaning of 4 U.S.C. § 111. But in answering this question, the Court did no more than analyze the plain language of the statute and "apply settled precedent to a new set of facts." *United States v. Johnson*, 457 U.S. 537, 551 (1982). This kind of ordinary decisionmaking is not a candidate for nonretroactivity.

The Department of Taxation does not dispute, as it cannot, that Congress intended federal civil service benefits to be deferred compensation. *See e.g.*, 59 Cong. Rec. 6900 (Apr. 29, 1920) (federal pensions "should be looked upon as deferred wages."). Indeed, in 1953, Virginia's own Attorney General recognized that civil service retirement benefits are compensation for federal employment. *See* 1952-1953 Va. Op.Atty.Gen. 184-85 (1953).[5] *See also* Az.

[5] The Attorney General stated that a "retired civil employee of the United States Goverment, . . . receiving a pension as such" is barred

Op.Atty.Gen. 60-9-L (1959) (concluding that "federal civil service retirement income" is "compensation for personal service . . . as an officer or employee of . . . the federal government."). For the Department of Taxation now to contend that *Davis* established a new principle of law in holding that federal pensions are compensation is disingenuous. When it enacted its discriminatory tax in 1942, Virginia must have known, as this Court had held, that the constitutional interdiction of discriminatory taxation applies "whether the taxed income be salary *or some other form of compensation.*" *Graves v. New York ex rel. O'Keefe*, 306 U.S. at 486-87 (emphasis added). If *Davis'* treatment of federal annuities as compensation came as a surprise to the Department of Taxation, it has no one to blame but itself.

Davis *did not establish a new principle of law in rejecting Justice Stevens' dissent.* The Department of Taxation contends that *Davis'* second new principle is essentially its rejection of Justice Stevens' dissent. According to the Department of Taxation, prior to *Davis* it had no clue that a tax that singled out the state for preferential treatment *vis-a-vis* all others, including the federal government, violated intergovernmental tax immunity principles. This argument is dispelled by *Davis* itself.

Foremost, the Court in *Davis* rejected the dissent's argument that intergovernmental immunity principles only prohibit the states from singling out the federal government for discriminatory treatment. The Court held:

> In *Phillips Chemical Co.*, however, we faced that precise situation: an equal tax burden was imposed on lessees of private, tax-exempt property and lessees of federal property, while lessees of state property paid a lesser tax, or in some circumstances, none at all. Although we concluded that "[u]nder these circumstances there appears to be no discrimination

from holding public office in Virginia because "active or retired civil service employees who receive compensation are [statutorily] excluded from holding public office."

> between the Government's lessees and lessees of private property," 362 U.S. at 381, we nonetheless invalidated the State's tax.

489 U.S. at 815 n.4. Thus, far from establishing a new principle of law, *Davis* specifically anchored its holding in precedent.

Moreover, the language of the dissent itself is fatal to the Department of Taxation's argument:

> Arguably, the Court's holding today is merely a logical extension of our decisions in *Phillips Chemical Co.* and *Memphis Bank & Trust v. Garner*, 459 U.S. 392 (1983). Even if it were, I would disagree with it.

489 U.S. at 824 (Stevens, J., concurring) (citation omitted). The dissent then goes on to challenge the holding in *Phillips*. 489 U.S. at 825 (Stevens, J., dissenting) ("The troublesome aspect of the Court's opinion in *Phillips* . . .").

Thus, *Davis* reveals a near unanimous Court concluding that its decision was compelled by *Phillips* and *Memphis Bank & Trust*, and a dissent that acknowledges that the decision may be "merely a logical extension" of those precedents. How the Department of Taxation can argue that this is the stuff of "new principles of law" is difficult to comprehend. By definition, a "logical extension of precedent" is not "an avulsive change [in the] current of the law." *Hanover Shoe, Inc.* 392 U.S. at 499.[6]

[6] The Department of Taxation contends that even after *Phillips* it had no clue that discriminatory taxation of federal compensation was impermissible. Other states, however, were quicker to discern the principles of nondiscrimination underlying the Public Salary Tax Act. *See, e.g.*, N.C. Code Ch. 158, § 317.1 (1939) (including federal "salaries, wages [and] other compensation" in the definition of gross income, provided "such income shall not be included in gross income, unless salaries, wages or other compensation received from the State of North Carolina . . . is subjected to income taxes imposed by the United States."). *See also* Legislative History of Ch. 293, Laws of Wisconsin 1939, Original Bill 1672 (recognizing that "salaries of federal officers, employes or other persons shall be

2. *The purposes underlying the intergovernmental tax immunity doctrine and the balance of the equities favor retroactivity*

In our opening brief, we argued that retroactive application of *Davis* would further the purposes of the intergovernmental tax immunity doctrine and the Supremacy Clause. The Department of Taxation's sole noteworthy response to this argument is the puzzling assertion that "petitioners suffered no harm to a right that is personal to them." Res. Br. at 27. Presumably, the Department of Taxation does not view having to pay an unconstitutional tax, or having property seized for refusing to pay such a tax, as "suffering a personal harm." Suffice it to say that petitioners feel the harm inflicted upon them quite directly; the legislature's indifference to their pleas and its refusal to amend its discriminatory tax until forced to do so by this Court, only add insult to their injury.

The Department of Taxation's position is most outlandish in its assertion that refunding a fraction of the money it unconstitutionally collected from petitioners would be inequitable. Of course the Department of Taxation does not respond to our argument that its equitable plea puts a premium on massive constitutional violations: from the states' perspective, the greater the constitutional violation the better, for then the greater the equitable claim not to right the wrong. Nor does the Department of Taxation tell us how it is that the constitutionality of its actions can hinge on the state of its fisc—could it truly be that a different result would ensue had this case been brought in Wisconsin before that state distributed a $250 million surplus? *See* Brief *Amicus Curiae* of The Military Coalition, at 18-19 n.16. And of course, the Department of Taxation does not provide the calculus by which this Court can determine when the state's cost of answering for its

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subject to no greater or different tax than the salaries of officers, employes or other persons of this state.").

unconstitutional acts becomes so high that the underlying conduct must be treated "as if" it were constitutional.[7]

The Department of Taxation's sole equitable claim is that a refund will cost a lot of money.[8] While federal retirees can only hope to see a dime of every dollar Virginia has unconstitutionally taken from them over the past decades, every penny the Department of Taxation now claims it would be inequitable to repay has been taken out of petitioners' pockets. The question becomes whether it is more equitable to leave this unconstitutional taking in place, and thus make a small and in many ways disadvantaged class of taxpayers bear its cost, or to distribute this loss to all the taxpayers in Virginia. In petitioners' view, merely to pose this question is to answer it.

At bottom, the Department of Taxation's argument is that this Court should allow states' purely parochial interests to dictate the reach of an unambiguous federal stat-

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[7] The courts are particularly ill-suited for the inquiry the Department of Taxation suggests should govern this case: "Where is the money better spent?" Nor would it be seemly for courts to determine whether states in fact have the revenues to pay the refunds. *See, e.g.*, Wash. Post, Mar. 2, 1991, § B, at 3, col. 5 ("The potential cost of the [retirees'] lawsuit was cited by Gov. L. Douglas Wilder . . . as one of the reasons for retaining a $200 million rainy-day fund in the current budget."). *See also* Wash. Post, Feb. 20, 1992, § B, at 5, col. 1 ("Virginia lawmakers have discovered that they have an $88 million windfall [because] the state had $1.1 billion more in its employee retirement fund than needed."); Winston-Salem Journal, Aug. 4, 1992, at 14, col. 1 (North Carolina "ended its fiscal year . . . with a balance of $164.8 million in the General Fund.").

[8] This Court has never balked at ordering relief simply because large sums are involved. For example, in *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855 (1983), this Court invalidated state taxes that gave rise to a refund claim of over $400 million in one state alone. *See* Note, "Protecting Federal Securities From Indirect State Taxation: *American Bank & Trust Co. v. Dallas County*," 37 Tax Law. 457, 465 n.78 (1984). *See also Aloha Airlines v. Hawaii Director of Taxation*, 464 U.S. 7, 14 n.10 (1983) ("We acknowledge that our interpretation . . . may result in the disruption of state systems of taxation; we are, however, bound by the plain language of the statute.").

ute. This argument wholly subverts the Supremacy Clause, for there is no principled basis for arguing that it is only the equities inherent in retroactivity jurisprudence that are sufficient to supervene a federal statute. And, if any state's perceived equities can negate an Act of Congress, then the Supremacy Clause will become a nullity. Petitioners see no equity in traveling down this path.

II. PETITIONERS ARE ENTITLED TO REFUNDS EITHER BY VIRTUE OF VIRGINIA'S REFUND STATUTE OR DIRECTLY UNDER THE FOURTEENTH AMENDMENT

The Department of Taxation argues that even if *Davis* is retroactive, petitioners are not entitled to relief. Neither Virginia's refund statute nor the Fourteenth Amendment, the Department of Taxation argues, provides petitioners an avenue of relief for the deprivation of property they sustained. The Department of Taxation is wrong on both scores, however, for the Constitution guarantees at a minimum that petitioners be afforded a "clear and certain remedy." *McKesson Corp. v. Florida Division of Alcoholic Beverages and Tobacco*, 496 U.S. 18, 39 (1990). Petitioners are entitled to refunds of the taxes unconstitutionally imposed upon them, and if Virginia's statute does not so provide, then the Fourteenth Amendment does.

The Department of Taxation starts by arguing that it is a "well-settled feature of Virginia law that equitable considerations were to determine the retrospective reach of decisions holding tax statutes unconstitutional." Res. Br. at 36. Thus, according to the Department of Taxation, Virginia's refund statute does not reach claims such as petitioners'.

This argument is astonishingly wrong; indeed, "it is like the thirteenth stroke of a crazy clock, which not only itself is discredited but casts a shade of doubt on all previous assertions." A. P. Herbert, M.P., *Uncommon Law* (Methuen & Co., Ltd. 1952) at 28. The retrospective

reach of a decision of this Court is a question of *federal* law, not state law. *Beam*, 111 S. Ct. at 2443. And, "[i]n order to ensure the uniform application of decisions construing constitutional requirements and to prevent States from denying or curtailing federally protected rights, [this Court has] consistently required that state courts adhere to [its] retroactivity decision." *American Trucking Ass'ns*, 496 U.S. at 178.

Moreover, if it was "well-settled" that Virginia's refund statute did not reach claims such as petitioners,[9] then it is difficult to understand why the General Assembly, "consistent with [its] notions of fairness to its citizens" (Res. Br. at 32), amended the refund statute to extend the limitations period for federal retirees to file refund claims. Indeed, given that the avowed purpose of the extension of the statute of limitations was to "protect[] the rights of federal retirees . . . until the retroactivity issue is finally decided by the courts," Joint Subcommittee Studying Taxation of Public and Private Retirement Benefits Initial Staff Report (Aug. 1989) at 4, even if Virginia's refund statute would not previously have reached petitioners' claims, it does now.[10]

Even if Virginia's statute did not reach petitioners' claims, however, they nonetheless would be entitled to relief under the Fourteenth Amendment.[11] As this Court held in *McKesson*,

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[9] *But see Corning Glass Works, Inc. v. Department of Taxation*, 402 S.E.2d 35, 40 (Va.), *cert. denied*, 112 S. Ct. 277 (1991) (reversing denial of refund of unconstitutional assessment of corporate income tax.)

[10] The Department of Taxation should be embarrassed to recall that in arguing to dismiss a related case filed in the United States District Court for the Eastern District of Virginia, it averred that Virginia's refund statute provided a "plain, speedy and efficient remedy." *See*, Defendants' Memorandum of Law in Support of Motion to Dismiss, *Lewy v. Commonwealth of Virginia* (E.D. Va. Apr. 24, 1989) at 4-6.

[11] The Department of Taxation's assertion that petitioners did not raise this argument below (*e.g.* Res. Br. at 36 n.42) is specious. *See* Reply Brief for Appellants (Nov. 27, 1990) at 13-15 (Reply

> [t]o satisfy the requirements of the Due Process Clause, . . . the State must provide taxpayers with not only a fair opportunity to challenge the accuracy and legal validity of their tax obligations, but also a "clear and certain remedy" for any erroneous or unlawful tax collection to assure that the opportunity to contest the tax is a meaningful one.

496 U.S. at 39, *quoting Atchison T. & S.F.R. Co. v. O'Connor*, 223 U.S. 280, 285 (1912). The Department of Taxation argues that *McKesson*'s requirement of a "clear and certain remedy" is limited to cases "where it is entirely foreseeable at the time of enactment that a tax will be contested and likely invalidated." Res. Br. at 38. But plainly *McKesson* is not so limited. *See, e.g.*, 496 U.S. at 31 ("the question before us is whether prospective relief, by itself, exhausts the requirements of federal law. The answer is no . . ."). Indeed, the Department of Taxation's suggested standard is tantamount to the qualified immunity standard under 42 U.S.C. § 1983; yet there is no requirement that a taxpayer demonstrate bad faith to be entitled to a remedy for the unconstitutional taking of his property.

The Department of Taxation's argument that *McKesson* is inapposite because Virginia provides a meaningful predeprivation remedy is similarly flawed. First, because Virginia's refund statute provides petitioners relief, it is irrelevant whether they may have had another means by which to recover the unconstitutional taxes. *McKesson* does not stand for the proposition that a state may ignore its own refund statute (and thus deny retroactive relief) simply because there may be a predeprivation redemy. If, as the Department of Taxation contends, Virginia has "provide[d] broader relief than is required by the Constitution," 496 U.S. at 52 n.36, it nonetheless may not curtail that refund right and thus deprive a taxpayer of

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Brief section captioned "Absent a statutory entitlement to relief, the Fourteenth Amendment would mandate refunds"). *See also* Res. Br. at 46 (responding to this argument).

"all existing remedies." *Brinkerhoff-Faris Trust & Sav. Co. v. Hill*, 281 U.S. 673, 682 (1930).

More fundamentally, the Department of Taxation is simply wrong in asserting that Virginia provides a meaningful predeprivation remedy. That the Tax Commissioner may have discretion to settle claims of questionable constitutionality (Res. Br. at 47) does not provide petitioners with a "certain" remedy. And while the Department of Taxation suggests that the Tax Commissioner can determine that a tax is unconstitutional, in fact he has no such authority under Virginia law. *See Holland v. Johnson*, 403 S.E.2d 356, 357-58 (Va. 1991) (only the courts have the power "to expound the laws and adjudicate cases."). *See also James City County v. Rowe*, 216 S.E.2d 199, 205 (Va. 1975) (because administrative tribunal could not avoid the command of the statute "there was no administrative remedy equal to the relief sought."). It is a familiar tenet of administrative law that "[o]nly the courts have authority to take action which runs counter to the expressed will of the legislature," K. Davis, *Administrative Law Text*, § 20.04 at 388-89 (3d ed. 1972), and Virginia is no exception. If the Tax Commissioner exonerates taxpayers from paying taxes he determines to be unconstitutional, he is acting beyond his authority. In any event, suffice it to say it is far from "clear" that the Tax Commissioner has this authority.

CONCLUSION

For the foregoing reasons, the decision of the Supreme Court of Virginia denying petitioners entitlement to refunds of taxes imposed on their federal pensions in violation of 4 U.S.C. § 111 and the intergovernmental tax immunity doctrine of the Supremacy Clause must be reversed. *Davis* must be applied retroactively and, either under Virginia's refund statute or directly under the Fourteenth Amendment, petitioners must be paid refunds.

Respectfully submitted,

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF *AMICUS CURIAE* ON BEHALF OF THE MILITARY COALITION IN SUPPORT OF PETITIONERS

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QUESTION PRESENTED

Whether this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstances be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

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BRIEF *AMICUS CURIAE* ON BEHALF OF THE MILITARY COALITION IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICUS CURIAE*

Pursuant to Rule 37.3 of the Rules of this Court, The Military Coalition (herein "TMC") respectfully submits this brief as *amicus curiae*.[1] TMC is a voluntary association of 24 military-related organizations which was formed six years ago (App. A, 1a). Collectively its constituent organizations represent the interests of over 1,500,000 members, who are retired, reserve and active members of the Uniformed Services of the United States. TMC is dedicated to the purpose of providing a cohesive means for the study and advocacy of issues which impact

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[1] *Amicus* has received the written consents of the parties to the filing of this brief; those consents have been filed with the Clerk of the Court.

upon the maintenance of a strong national defense and the preservation of rights and benefits its varied constituents have earned through years of dedicated service to the United States.

The State of Virginia and approximately thirteen other states continue to refuse to give retroactive effect to this Court's decision in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989). The resolution of the question presented in this case is vitally important to *amicus*. If the decision below is permitted to stand, military retirees and, indeed, military members on active duty throughout the fifty states will be at risk that rights established by Congress may be arbitrarily abridged by any state solely on the basis of local political considerations. *Amicus* has supported the enactment of several measures by Congress which prohibit discrimination of the type upheld by the decision below. Thus, *amicus* has a unique perspective on the question presented by this case as well as a vital interest in its proper resolution.

SUMMARY OF THE ARGUMENT

In the decision below, the Virginia Supreme Court misconceived its analytical task. Under the Supremacy Clause, its sole function was to enforce 4 U.S.C. § 111 in accordance with its terms. Since the Virginia scheme of taxation violated Congress' limited consent to the taxation of federal compensation, the court below erred in failing to find that the Virginia taxing scheme had been pre-empted.

Upon remand from this Court in the October Term of 1990, the court below also erred in refusing to apply this Court's judgment in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2239 (1991). Under *Beam*, it is unmistakable that state courts are obligated to give this Court's decision in *Davis* retroactive effect.

Alternatively, if this Court concludes that a prospectivity analysis is appropriate in determining the effect of

unambiguous Congressional enactments, under the three-prong test it was error for the Virginia Supreme Court to refuse to give 4 U.S.C. § 111, as construed in *Davis*, retroactive effect.

Under the first prong, there is no new principle. 4 U.S.C. § 111 merely codifies this Court's decisions. Similarly, the State's claim of reliance on its own statute is inadequate to satisfy this threshold prong. This is so, in part, because Virginia ignored its own 1982 determination that its scheme was inequitable.

Under the second and third prongs, the State has demonstrated nothing which would justify refusing to give effect to a lawful enactment of Congress. Indeed, under the circumstances of this case, the failure to give *Davis* retroactive effect results in a new violation of 4 U.S.C. § 111.

With respect to the equities, Virginia comes to this Court with unclean hands. The burdens, if any, in this case are of the State's own making and are directly related to considered parochial choices which its legislature has voluntarily made. Moreover, the burden, which Virginia claims in this case, is attributable in large measure to its attempt to finance its choices by singling out the petitioners to shoulder a tax burden that similarly situated citizens of Virginia have not and are not being required to bear.

Finally, it is clear that the decisions of this Court preclude the result ordered below. Virginia seeks to retain the benefits of 4 U.S.C. § 111, while at the same time it claims that, as to the petitioners, 4 U.S.C. § 111 was not the law. A state cannot retain the benefits of legislation and at the same time attack the validity of the same act. Similarly, as to tax year 1988, Virginia seeks relief from a burden of its own making. Under the precedents of this Court, such relief is foreclosed.

Since none of the factors for prospectivity are satisfied and since Virginia is precluded from invoking the defense

in the first instance, 4 U.S.C. § 111, as construed in *Davis*, should be given retroactive effect. The Virginia legislature has waived all procedural bars to the refunds claimed. As a matter of federal law, *amicus* urges this Court in its mandate to compel Virginia to pay refunds upon remand.

ARGUMENT

I. THE COURT BELOW MISCONCEIVED THE PROPER ANALYTICAL TASK.

Amicus respectfully submits that the Virginia Supreme Court "misconceived the appropriate analytical task," *Patterson v. Shumate*, 112 S. Ct. 2242, 2248 n.4 (1992), in reaching its holding that "the *Davis* decision is not to be applied retroactively." Pet. App. at 17a. Given the clarity of the statutory provision at issue in *Davis*, the decisions of this Court establish that "the sole function" of the court below should have been "to enforce [the statute] according to its terms." *West Virginia Univ. Hosp., Inc. v. Casey*, 111 S. Ct. 1138, 1147 (1991) (citations omitted). *See also Patterson v. Shumate*, 112 S. Ct. at 2247; *United States v. Ron Pair Enter., Inc.*, 489 U.S. 235, 241 (1989).[2]

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[2] Virginia's defense in this case was based upon an appeal to parochial considerations. (J.A. 32-49). However, as Justice Holmes observed:

> Great cases like hard cases make bad law. For great cases are called great, not by reason of their real importance in shaping the law of the future, but because of some accident of immediate overwhelming interest which appeals to the feelings and distorts the judgment. These immediate interests exercise a kind of hydraulic pressure which makes what previously was clear seem doubtful, and before which even well settled principles of law will bend. What we have to do in this case is to find the meaning of some not very difficult words. We must try, I have tried, to do it with the same freedom of natural and spontaneous interpretation that one would be sure of if the same question arose upon an indictment for a similar act which excited no public attention, and was of importance only to a prisoner before the court. Furthermore, while at times judges need for their work the training of economists or statesmen, and must act in view of their foresight of consequences, *yet when their task is to interpret and apply the words of a statute, their function is merely academic to begin with—to read English intelligently—and a consideration of consequences comes into play, if at all, only when the meaning of the words used is open to reasonable doubt.*

Northern Sec. Co. v. United States, 193 U.S. 197, 400-01 (1904) (Holmes, J., dissenting) (emphasis added).

In exercising its judicial function to enforce 4 U.S.C. § 111, the Virginia Supreme Court should have given effect to the considered decision of Congress in establishing the effective date of the Act. *See* Public Salary Tax Act of 1939, Title I, § 4 (App. B at 8a); *Meredith v. State Tax Comm'n*, 163 Or. 305, 312-13, 96 P.2d 1082 (1939) (recognizing that the effective date of the Act as enacted by Congress is controlling.). A state court is "'not at liberty to create an exception where Congress has declined to do so.'" *Freytag v. Commissioner*, 111 S. Ct. 2631, 2636 (1991) (citation omitted). *See also Patterson*, 112 S. Ct. at 2250. The pre-emption of Virginia's discriminatory tax was "compelled". *See Adams Fruit Co. v. Barrett*, 494 U.S. 638, 642 (1990) (citation omitted). *See also Gregory v. Ashcroft*, 111 S. Ct. 2395, 2409 (1991) (White, J., dissenting) ("'The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the framers of our Constitution provided that the federal law must prevail.'") (citations omitted).

Amicus also submits that the decision of the court below was foreclosed by its obligations under the Supremacy Clause as well as principles of *stare decisis*. *See McKesson v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 29 (1990) ("State courts must interpret and enforce faithfully the 'supreme Law of the Land' . . . ."). *See also Planned Parenthood of South-*

eastern Pennsylvania v. Casey, 60 U.S.L.W. 4795, 4817 (1992) (Stevens, J., concurring in part and dissenting in part) ("[T]he doctrine of *stare decisis* has controlling significance in a case of this kind, notwithstanding an individual justice's concerns about the merits."). Although there were several opinions in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2238 (1991), the mandate of this Court's judgment in *Beam* is unmistakable:

> [A]ny consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court. . . . Because the Court in *Bacchus* remanded the case solely for consideration of the pass-through defense, it thus should be read as having retroactively applied the rule there decided. . . . *Cf. Davis v. Michigan Dep't of Treasury*, 489 U.S. 803, 817, 109 S. Ct. 1500, 1508, 103 L. Ed. 2d 891 (1989).

Id. at 2445-46 (footnote and citations omitted).

In *Davis*, Michigan's concession as to the appropriate retroactive remedy would have been of no moment unless this Court first had found the scheme unlawful for the years at issue therein (1979-1984). *Davis*, 489 U.S. at 806-07. *Cf. Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, 60 U.S.L.W. 4582, 4586 (1992) (Rehnquist, C.J., dissenting) ("[A] stipulation between parties cannot bind this Court on a question of law."). *Amicus* submits that after this Court had applied the rule of law to the litigants in *Davis*, it was erorr for the Virginia Supreme Court to use the pretext of the prospectivity defense to deny the Petitioners retroactive relief. *Beam*, 111 S. Ct. at 2448.

II. ALTERNATIVELY, ASSUMING THIS COURT DETERMINES THAT A PROSPECTIVITY ANALYSIS MAY BE APPLIED IN THIS CASE, *DAVIS* SHOULD BE GIVEN RETROACTIVE EFFECT.

Assuming this Court is persuaded that it should apply the prospectivity test of *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), *amicus* submits that an even-handed *Chevron* analysis requires that the provisions of 4 U.S.C. § 111 as construed in *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), be given retroactive effect.

A. *Davis* Did Not Establish a New Principle of Law. Therefore, the Threshold Prong for Prospectivity Is Not Satistfied.

The first prong of the prospectivity test requires that "the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed." *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202, 3203 (1990) (per curiam) (citations omitted). Decisions must be retroactively applied if this threshold test is not met. *Id.* at 3205. The test under the first prong is a rigorous one, which is narrowly applied. *Id.*[3] Since *Davis* "*was not revolutionary*," it does not meet the first prong. *Id.* (emphasis added).

The State contends that *Davis* decided an issue of first impression whose resolution was not clearly foreshadowed. It supports this assertion by contending that it

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[3] In applying its decision in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), retroactively to invalidate a West Virginia tax which had been in effect for over 50 years, the Court refused to characterize its decision in Armco as having "overrul[ed] clear past precedent on which litigants may have relied" merely because it was inconsistent with a nearly identical decision in the case of *Columbia Gas Transmission Corp. v. Rose*, 459 U.S. 807 (1982), which the Court dismissed for want of a substantial federal question a year prior to the Court's decision in *Armco*. *Id.* at 3205 n*.

relied upon a presumptively valid taxing statute. (Pet. App. C at 10a). However, "where the power to tax is not unlimited, validity is not established by the mere imposition of a tax." *Mullaney v. Anderson*, 342 U.S. 415, 418 (1952).[4]

Contrary to the State's assertion, since 1939 it has been settled that the States only had the power to impose "nondiscriminatory" taxes upon the "compensation" of employees of the United States. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 487 (1939). In so holding, the Court observed that it perceived "no basis for a difference in result whether the taxed income be salary or some *other form of compensation* . . . ." *Id.* at 486 (emphasis added). This rule was codified in the Public Salary Tax Act of 1939. *See Davis*, 489 U.S. at 812.[5] Since then, nothing in the law has changed which would permit Virginia to invoke the limited prospectivity exception.

In resolving the question of statutory construction at issue in *Davis*, this Court applied settled principles under the doctrine of intergovernmental immunity. First, implicit in the Court's analysis in *Davis* was recognition

[4] Analytically, Virginia does not, in fact, seek the application of the prospectivity exception. Virginia really is asking this Court to switch off the rule of law and grant it an exemption from the application of the unambiguous provisions of 4 U.S.C. § 111 so that it can continue to enforce its invalid scheme for all tax years prior to the 1989 tax year.

[5] *See also* S. Rep. No. 112, 76th Cong., 1st Sess. at 9 (1939) ("[T]he proposal before us provides only for nondiscriminatory taxation of the compensation of public employees and is reciprocal in nature. Thus, whatever burden might be passed on to one government because of the taxation of its employees' compensation by another governmental unit would, in a measure at least, be offset by the converse application of the proposal."); *The Taxation of Municipal Obligations and Salaries*, A Report of the Committee on Taxation of Municipal Obligations and Salaries, Municipal Law Section of the American Bar Association, at 13 (July 11, 1939) (*Graves* preserves the rule of intergovernmental tax immunity).

that the law has always been that the federal government "possesses the power to enact statutes immunizing those with who it deals from state taxation even if [the] intergovernmental tax immunity doctrine would not otherwise confer an immunity." *South Carolina v. Baker*, 485 U.S. 505, 519 n.11 (1988) (citing *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 478 (1939)). Second, a State is required to treat "those who deal with the Government as well as it treats those with whom it deals itself." *Phillips Chem. Co. v. Dumas Sch. Dist.*, 361 U.S. 376, 385 (1960). Third, "[t]he imposition of a heavier tax burden on [those who deal with one sovereign] than is imposed on [those who deal with the other] must be justified by significant differences between the two classes." *Id.* at 383.

These settled principles are of particular significance because they have been consistently applied in earlier cases involving the doctrine of intergovernmental tax immunity. *See, e.g., United States v. City of Manassas*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 485 U.S. 1017 (1988); *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983); *Chase Manhattan Bank, N.A. v. Finance Admin.*, 440 U.S. 447 (1979) (per curiam); *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, *reh'g denied*, 366 U.S. 947 (1961). *See also Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986).

Virginia's contention that *Davis* was not clearly foreshadowed is unpersuasive.[6] *Davis* is replete with analysis which unequivocally demonstrates that the law in this

[6] The State contends that the rule of *Davis* should not be applied here. Under *Chevron*, presumably then this case would be controlled by the pre-*Davis* old rule of law. Ignoring the plain text of 4 U.S.C. § 111, the old rule of law in such a circumstance would be *Graves*, *supra*, and *Phillips Chem. Co.*, *supra*. If the court below had applied the old rule of law, the result reached under *Graves* would have been identical to that of the *Davis* decision.

area was clearly established prior to *Davis*. Significantly, Michigan unsuccessfully attempted to persuade this Court to depart from clearly established law. Michigan's invitation was rejected: "The state offers no reason for departing from this *settled rule*, and we decline to do so." *Davis*, 489 U.S. at 815 (emphasis added). Moreover, *Davis* begins with the dispositive holding that:

> [T]he overall meaning of § 111 is *unmistakable*: it waives whatever immunity past and present federal employees would otherwise enjoy from state taxation of . . . retirement benefits . . . paid on account of their employment with the Federal Government, except to the extent that such taxation discriminates on account of the source of compensation.

Id. at 810 (emphasis added). Any other "hypertechnical reading" of the statute would be "implausible at best." *Id.* at 809-10. *Davis* did not announce a new principle of law. It merely affirmed, under settled legal principles, that Mr. Davis, like the federal retirees here, cannot legally be subjected to a discriminatory state tax.

The Court in *Davis* also emphasized that the long standing principle of intergovernmental tax immunity, as codified in 4 U.S.C. § 111, has its "genesis in *M'Culloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819)." *Davis*, 489 U.S. at 810. In *M'Culloch*, the Court held that the State of Maryland could not impose a discriminatory tax on a federal instrumentality of the United States. The *Davis* court further noted that, after the decision in *Graves v. New York, supra*:

> [I]ntergovernmental tax immunity barred only those taxes that were imposed directly on one sovereign by the other or that discriminated against a sovereign or *those with whom it dealt*.

Davis, 489 U.S. at 811 (emphahis added). The *Davis* court stated that the nondiscrimination component of the constitutional immunity doctrine has, from the time of *M'Culloch v. Maryland*, barred taxes that "'operat[e] so as to discriminate against the Government or those

with whom it deals.'" *Id.* at 812 (citations omitted). The Court also observed that 4 U.S.C. § 111 was drafted "against the backdrop" of this Court's earlier tax decisions and, as such, is "coextensive with the . . . modern constitutional doctrine of intergovernmental tax immunity." *Id.* at 813.

Rejecting Michigan's argument that individuals should not receive protection of the constitutional doctrine of intergovernmental imunity, the *Davis* decision held that "*all precedent* is to the contrary." *Id.* at 814 (emphasis added). This statement evidences two crucial points which *amicus* submits compel the conclusion that the law applied in *Davis* was clearly foreshadowed. First, it shows the existence of prior decisions directly on point. The *Davis* Court listed no fewer than five of its tax decisions dating back to 1842 in support of the proposition that federal retirees may not be taxed discriminatorily. *Id.* at 815. Second, it demonstrates that the law in this area has been consistent. *Id.* This explains why the Court viewed the law as "settled." The *Davis* decision was an inevitable and unmistakable conclusion based upon existing precedent. Accordingly, *Davis* does not represent "such an abrupt and fundamental shift in doctrine as to constitute an entirely new rule . . . ." *Hanover Shoe, Inc. v. United States Shoe Mach. Corp.*, 392 U.S. 481, 498 (1968).

In the wake of *Davis*, some states, similar to Michigan's argument before this Court, initially feigned surprise at the *Davis* decision because they claimed that they did not realize that the provisions of § 111 prohibiting discrimination in the taxation of the compensation of a federal employee included discriminatory taxation of pensions.[7] Stated another way, these states claimed that

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[7] Indeed, Michigan's assertion in *Davis* was nothing more than a "'cloak for discrimination'" against federal pension benefits. *Barker v. Kansas*, 112 S. Ct. 1619, 1626 (1992) (citation omitted). Michigan, like several other states, has justified the constitution-

they did not realize that pensions were "compensation." However, it is clear that Virginia recognized that the taxation of federal pensions is the taxation of compensation for personal services rendered to the United States. *See Report of the House Finance Retirement Subcommittee to the Governor and the General Assembly of Virginia*, December, 1982, at 8 ("Although further differences in treatment among the different classes of retirees can be listed, tax laws should not distinguish the components of *compensation* . . . .") (emphasis added). (App. D at 15a).

Although Virginia should be precluded from reasserting here the hypertechnical argument of Michigan, it is indisputable that the *Davis* Court's holding that "retirement benefits are deferred compensation" for purposes of 4 U.S.C. § 111 was clearly mandated by the plain language of the statute. *Davis*, 489 U.S. at 808.

The term "compensation for personal service", as used in the Internal Revenue Code at the time of the adoption of the Public Salary Tax Act included pensions,[8] and more specifically, the *pensions of retired government employees.*[9] In addition, based upon the doctrine of intergovernmental tax immunity, state pensions, because they represented compensation, had consistently been excluded from federal income taxation prior to the passage of the Public Salary Act of 1939.[10]

Virginia accepted and understood that pensions were compensation for purposes of Title II of the Act. This title provided total immunity from the federal income tax for employees and retirees of Virginia's state and local subdivisions with respect to their "compensation," including pensions for personal services rendered to state and local governments for all years prior to 1939. *See* Public Salary Tax Act of 1939, Ch. 59, Title II (App. B at 9a-12a). The State also understood that pensions were compensation for purposes of Title I of the Act, because before 1939, the State could not and did not tax any "other form of [federal] compensation." *Graves*, 306 U.S. at 486. It is indisputable that pensions are compensation for personal services and that state and federal pensions have always been subject to the doctrine of intergovernmental tax immunity and § 111.[11] Against

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ality of its income tax of former residents on the basis that pensions are deferred compensation for services rendered at an earlier point in time. *See Molter v. Department of Treasury*, No. 125786, 1992 Mich. App. Lexis 131 (Ct. App. April 6, 1992). *See also*, Op. Ariz. Att'y Gen. No. 60-9-L (1959) (federal pension benefits represent deferred compensation for personal services as an officer or employee of the federal government) (App. C at 13a-14a).

[8] The Public Salary Tax Act specified that its "terms * * * shall have the same meaning as when used in Chapter I of the Internal Revenue Code." *Id.*, Title II, § 206. (App. B at 11a).

[9] Pensions or retirement allowances paid by the United States have been deemed part of the recipient's compensation for personal services since 1919. *See, e.g.*, Treas. Reg. 45, Art. 32 (1919); Treas. Reg. 86, Art. 22(a)-2 (1935); Treas. Reg. 101, Art. 22(a)-2 (1930); *see also* Treas. Reg. § 1.61-2(a)(1). It has been clear from the date of the enactment of the United States Civil Service Retirement System in 1920 that the pension payments made by the federal government to its retired employees are compensation for personal services. *See* 59 Cong. Rec. 6300 (April 29, 1920) (statement of Representative Hamil: "Pensions are not gratuities * * * they should be looked upon as deferred wages—as payments of wages which were not disbursed at the time they were earned.").

[10] I.T. 1607, II-2 C.B. 71 (1923) ("Inasmuch as salaries and wages received by officers and employees of a State are exempt from taxation . . . it is held that the retirement allowance given employees of the State of New York under the New York State Employees' Retirement System represents compensation for past services rendered and is exempt from taxation."); I.T. 2669, XII-1 C.B. 68 (1933) (pensions paid to a person who rendered services as an officer or employee of a State or political subdivision thereof "represent compensation paid for past services rendered, and since the compensation in such cases was exempt from Federal income tax the pensions are also exempt from Federal income tax.").

[11] Federal tax cases have also consistently held that pensions are compensation for personal services. *Hooker v. Hoey*, 27 F. Supp. 489, 490 (S.D.N.Y.), *aff'd*, 107 F.2d 1016 (2d Cir. 1939); *Sharpe*

this background the State's assertion that *Davis* was a surprise is untenable.[12]

Virginia's claimed reliance interest in its statute is mere "cant." *Commissioner v. Newman*, 159 F.2d 848, 851 (2d Cir.), *cert. denied*, 331 U.S. 859 (1947) (Hand, J., dissenting). Virginia's contention ignores the practical realities of an income tax. Unlike property, use or transaction taxes, Virginia's income tax is wholly subject to the vagaries of life. Setting aside constitutional issues, the income tax may be avoided or mitigated by proper planning and/or the occurrence of a host of unforeseen/unpredictable events (*e.g.*, catastrophic medical expenses, casualty losses, bad investments, business losses, charibtable donations and in some instances, even gambling

v. United States, 54-2 USTC (CCH) ¶ 46,902 (W.D. Wash. 1954) (retirement payments to taxpayer were in consideration of his status as an employee of the State of Washington and were taxable); *Simpson v. United States*, 236 F. Supp. 433 (D. Conn. 1964). *See also* Rev. Rul. 56-82, 1956-1 C.B. 59 (recognizing that the Public Salary Tax Act limits the federal taxation of state pensions); Treas. Reg. § 1.161-2(a) (defining compensation for services to include pensions).

[12] Even without the intervention of the *Davis* decision, the prevailing authority of the states' highest courts and Virginia's own administrative rulings clearly foreshadowed the outcome of the issue. *See, e.g.*, Ruling of Commissioner, P.D. 88-7, [2 Va.] St. Tax Rptr. (CCH) para. 201-546; *Forbes, Inc. v. Department of Fin.*, 66 N.Y.2d 243, 487 N.E.2d 251 (1985), *cert. denied*, 475 U.S. 1109 (1986); *Brown v. Franchise Tax Bd.*, 197 Cal. App. 3d 300, 242 Cal. Rptr. 810 (1987); *Andras v. Department of Revenue*, 154 Ill. App. 3d 37, 506 N.E.2d 439 (1987), *cert. denied*, 485 U.S. 960 (1988); *Commissioner of Revenue v. Plymouth Home Nat'l Bank*, 394 Mass. 66, 473 N.E.2d 1139 (1985) (decided under state law); *Matz v. Department of Treasury*, 155 Mich. App. 778, 401 N.W.2d 62 (1986); *In re Sawyer Estate*, 149 Vt. 541, 546 A.2d 784 (1987); *Capital Preservation Fund v. Department of Revenue*, 145 Wis. 2d 841, 429 N.W.2d 551 (Ct. App. 1988). *See also Borg v. Department of Revenue*, 308 Or. 34, 774 P.2d 1099, 1101-02 (1989) ("The nondiscrimiantion rule of *Davis v. Michigan Dep't of Treasury, supra*, requires the same result.").

losses). *See, e.g.*, Code § 58.1-322 D.1.a. (App. E at 17a); Ruling of Commissioner, P.D. 88-30, [2 Va.] St. Tax Rptr. (CCH) para. 201-563 (permitting deduction of gambling losses and related expenses). Moreover, even when the tax is paid, the state has no settled expectation or reliance on the revenues collected until the applicable limitations periods for refunds and carryovers (carrybacks or carryforwards) have expired. *See e.g.*, Ruling of Commissioner, P.D. 87-253, [2 Va.] St. Tax Rptr. (CCH) para. 201-519 (permitting net operating loss carryback from 1985 to 1982 and abating 1982 assessment); Ruling of Commissioner, P.D. 90-217, *Id.* at para. 201-930 (permitting net operating loss carryback from 1989 to 1986); Ruling of Commissioner, P.D. 90-11, *Id.* at para. 201-844 (authorizing refund filed within three years from the extended date of the original return).

Certainly, Virginia did not presume that it would be able to defend its scheme from substantive attack under 4 U.S.C. § 111 on the basis of the jurisdictional defense asserted in *Waldron v. Collins*, 788 F.2d 736 (11th Cir.), *cert. denied*, 479 U.S. 884 (1986). Similarly, by at least October of 1986, Virginia should have been on notice of the parameters of the relevant inquiry governing state taxing schemes which discriminate against those who deal with the federal government. *See United States v. City of Manassas*, 830 F.2d 530 (4th Cir. 1987), *aff'd*, 485 U.S. 1017 (1988).[13]

Virginia's attempt to enhance its claimed reliance interest from the lack of litigation is also disingenuous. First, there is no protest requirement in Virginia. More significantly, however, Virginia's argument is untrue. Since at least 1982, there has been significant, widespread protest by federal retirees to Virginia's discriminatory

[13] This case was argued to the Fourth Circuit on October 10, 1986 and the Virginia Attorney General appeared on brief for the defendants, which included the State Tax Commissioner of the Commonwealth of Virginia. *Id.*

income tax scheme of federal pensions. In response to this protest, a legislative committee was appointed to study the issue. *See Report of the House Finance Retirement Subcommittee to The Governor and The General Assembly of Virginia*, December, 1982, at 4 ("The subcommittee was to examine in particular the individual income tax treatment of military and civil service retirement benefits."). (App. D, 15a). After taxpayer hearings, *Id.* at 23, the committee concluded that remedial legislation was required to cure the "inequity" of the income tax scheme and recommended legislation that would treat "*all* retirees equally." *Id.* at 24. Certainly, petitioners cannot be faulted for having first invoked the political process, albeit unsuccessfully. Stated another way, the State cannot claim a reliance interest where it has disregarded the recommendations of its own political process.[14]

In addition, the fact that Virginia's discriminatory scheme has been in effect for many years does not give rise to a reliance interest under *Chevron*. *See Ashland Oil*, 110 S. Ct. at 3205 n.*. In a similar vein, it is

[14] The futile efforts of federal retirees to obtain pre-*Davis* legisltaive relief from discriminatory state taxation were not unique to Virginia. *See, e.g.*, Petitioners' Reply Brief at 2, *Barker v. Kansas*, 112 S. Ct. 1619 (1992) (No. 91-375) (establishing ongoing efforts from 1971); Index of Record 111, 121, 125, 239, *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990), *aff'd on reconsideration*, 167 Ariz. 344, 807 P.2d 1 (1991), *appeal pending*, No. 1 CA-TX 91-008 (establishing ongoing efforts from the late 70's); Exhibits 10 through 24, *Hagge v. Iowa State Dep't of Revenue and Fin.*, Iowa District Court, Linn County, No. LA 20859 (establishing ongoing efforts from at least 1976); Petitioners' Motion for Recusal, *Hogan v. Musolf*, Wisconsin Tax Appeals Commission, No. 91-I-386 (establishing ongoing efforts from the mid-60's); Exhibits 7 through 33, *Ponthier v. Louisiana Dep't of Revenue*, Louisiana Board of Tax Appeals, No. 3396 (establishing ongoing efforts from the late 70's); Record on Appeal 349-365, *Swanson v. Powers*, No. 89-282-CIV-5H (E.D.N.C. 1990), *rev'd in part*, 937 F.2d 965 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 871 (1992) (establishing ongoing efforts from the late 70's).

clear that the sheer number of states violating a Congressional mandate has never been a proper justification for unlawful state enactments. *See South Carolina v. Baker*, 485 U.S. 505, 515 (1988).

Since the State cannot satisfy the threshold test of a "wholly new issue of first impression," *Davis* must be applied retroactively. *See Ashland Oil*, 110 S. Ct. at 3205. *See also United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991) ("Our decision striking down this tax does not meet the tests of nonretroactivity. We overrule no precedent and we do not decide an issue of first impression.").

B. Retroactive Application of *Davis* Will Further the Purposes Behind 4 U.S.C. § 111 and the Doctrine of Intergovernmental Tax Immunity.

Under the second prong of *Chevron*, a court "'must weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.'" *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971) (citations omitted).

The State contends, and the court below summarily concluded, that, because the state statute at issue was repeated prospectively, this prong had been satisfied. (Pet. App. C at 12a). This summary observation can hardly be deemed adequate.

Had a meaningful inquiry been undertaken in the decision below, the Virginia Supreme Court would have been forced to conclude that the purpose of the rule could be furthered only by retrospective operation. The court's failure to apply *Davis* retroactively, in fact, frustrates the operation of the rule.

In *Trinityfarm Constr. Co. v. Grosjean*, 291 U.S. 466, *reh'g denied*, 292 U.S. 604 (1934), the Court observed that:

> [The] application [of the intergovernmental tax immunity doctrine] does not depend upon the *amount of exaction, the weight of the burden or the resulting interference with sovereign independence.* Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree . . . . Its right application is essential to the orderly conduct of the national and state governments and the attainment of justice between them.

Id. at 471 (emphasis added).

As recently observed by the Ninth Circuit in an analogous case, the rule of law implicated in this case involves a "fundamental principle," *United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), which had its genesis in *M'Culloch v. Maryland*, 17 U.S. 316 (1819). *See also Graves v. New York ex rel. O'Keefe*, 306 U.S. 466 (1939). Retroactive application of the decision here "will surely foster a proper respect for that principle," *United States v. City of Spokane*, 918 F.2d at 89, by encouraging states to tread carefully when they impose taxes upon those who deal with the federal government.[15] It appears that this principle is now observed only in the breach. *See Cambridge State Bank v. James*, 480 N.W.2d 647 (Minn. 1992), *petition for cert. pending*, No. 91-2047.[16]

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[15] Retroactive application here will also have the salutary effect of reminding state courts of their obligation under the Supremacy Clause. *See McKesson*, 496 U.S. at 29 ("State courts must interpret and enforce faithfully the 'supreme Law of the Land . . . .'"). It will serve to deter future "result-oriented decision[s] arrived at for the [sole] purpose of protecting the state's coffers." *Sheehy v. State, Dep't of Revenue*, 820 P.2d 1257, 1269 (Mont. 1991), *petition for cert. pending*, No. 91-1437 (Trieweiles, J., dissenting).

[16] This is further illustrated by the conduct of the states in the context of *Davis*-related litigation. Two months after the commencement of *Davis*-related litigation and the confirmation of the estimate of refunds mandated thereunder, the Wisconsin legislature enacted 1989 Wisconsin Act 31, an election year refund program, thereby dissipating a $250 million unappropriated surplus. The State then proceeded to defend, *inter alia*, on the ground that its refund obligation should be excused under *Chevron* because the State could not afford to pay refunds. TR. 5, 13, 15, *Hogan v. Musolf*, 163 Wis. 2d 1, 471 N.W.2d 216 (1991), *cert. denied*, 112 S. Ct. 867 (1992). In Alabama *Davis*-related litigation, the State attempted to defend on a similar basis, notwithstanding the fact that there was a surplus in excess of $53 million in the fund from which refunds were to be paid. *Rinehart v. Sizemore*, No. CV-89-704-M, *slip op.* at 5-6 (Montgomery County Ct., Ala. October 10, 1990), *aff'd*, 1992 Alabama Civ. App. Lexis 183 (Ala. Civ. App. February 7, 1992). Arizona has pursued a similar strategy, while the defendants there continue to overfund their own state retirement fund, which at the commencement of the *Davis*-related case, was and is overfunded in excess of $1 billion *See* Arizona State Retirement System Annual Report June 30, 1990 at 30, *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (1990), *aff'd on reconsideration*, 167 Ariz. 344, 807 P.2d 1 (1991), *appeal pending*, No. 1 CA-TX 91-008.

A failure to apply *Davis* retroactively will also serve to eviscerate the careful balance struck under Title II of the Public Salary Tax Act of 1939 (App. B at 9a-12a). It is beyond question that state retirees have and continue to enjoy the benefits of this legislation. *See, e.g.*, Rev. Rul. 56-82, 1956-1 C.B. 59 (recognizing the exclusion for federal tax purposes of current state pension benefits attributable to certain pre-1939 contributions). Yet, if the decision below is permitted to stand, the principle, which the states will extrapolate from this case, will be that the states may freely claim the benefits of any federal legislation, but will be free to avoid any undesired burdens of such legislation by merely invoking the prospective defense.

Similarly, if the decision below is permitted to stand, the rights granted to federal retirees under 4 U.S.C. § 111 would be extinguished. As this Court has recently observed:

> [O]ur government 'has been emphatically termed a government of laws, and not of men. It will certainly cease to deserve this high appellation, if the laws furnish no remedy for the violation of a vested legal right.'

Franklin v. Gwinnett, 112 S. Ct. 1028, 1033 (1992) (quoting *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 163 (1803)). Here, the overriding purpose of the constitutional principle and the Act—to prevent discriminatory taxation—will be retarded if *Davis* is not given retroactive effect. Such a result "would harm separation of powers principles . . . by giving judges the power to render inutile" rights conferred by Congress. *See Franklin v. Gwinnett*, 112 S. Ct. at 1029.

In addition, if the decision below is permitted to stand, the interests of the United States would also be compromised. For over four decades, Virginia reduced its employment costs at the expense of the federal treasury. *See Davis*, 489 U.S. at 815 n.4. During that same period of time, it misappropriated substantial federal revenues by virtue of the discriminatory tax imposed upon federal retirees. These state exactions were deducted by numerous federal retirees under 26 U.S.C. § 164, directly reducing federal income tax collections for each of those years. (App. F at 23a).[17] Refunds of these taxes now will enable the federal government to recover part of the federal revenues misappropriated by Virginia in past years. Under the Tax Benefit Doctrine and section 111 of the Internal Revenue Code, any refund ordered will be subject to federal tax in the year received. (App. F at 23a). *See also* Rev. Rul. 79-315, 1979-2 C.B. 27. As a consequence of the Virginia Supreme Court's refusal to order refunds, the United States is currently being denied these tax revenues—revenues to which the United States is clearly entitled. The diversion of these revenues by Virginia represents a new violation of the doctrine of

[17] Approximately 35 million households took this itemized deduction on their 1987 federal tax returns. Based on data of the Internal Revenue Service for 1987, over 50% of households that deducted state and local taxes had incomes under $40,000 and 68% had incomes under $50,000. *See* Individual Income Tax Returns 1987, I.R.S. Pub. 1304 (rev. 8-90).

intergovernmental tax immunity.[18] *See Davis, supra*, 815 n.4.

C. Weighing the Equities Compels the Retroactive Application of *Davis*.

With respect to the third prong of *Chevron*, a court weighs the "inequity imposed by retroactive application" for the purpose of determining whether a decision will produce "substantial inequitable results if applied retroactively." *Chevron Oil Co. v. Huson*, 404 U.S. at 107. In the decision below, there was no weighing. The Virginia Supreme Court's analysis under this prong is virtually nonexistent. (Pet. App. C at 12a-14a). It consisted solely of the alleged financial burden upon the state. However, the relevant equities are far broader in this case.

The Virginia Supreme Court appears to have been persuaded by the State's contention that it is somehow inequitable for a state to be required to refund to its citizens taxes which have been unlawfully collected. This contention is breathtaking. Virginia "cannot object to a refund here just because it has other ideas about how to spend the funds." *McKesson*, 496 U.S. at 51 n.35 (1990). *See Swanson v. State*, 329 N.C. 576, 588, 407 S.E.2d 791, 797, *reh'g granted*, 330 N.C. 445, 410 S.E.2d 498, *adhered to on reh'g*, 330 N.C. 390, 410 S.E.2d 490 (1991), *petition for cert. pending*, No. 91-1436 (Mitchell, J., dissenting) ("There simply is nothing 'inequitable' or wrong about ordering that the state not pick a taxpayer's pocket or in requiring it to return the money when it is caught doing so.").

[18] In contrast to the State of Virginia, during this same period, the Internal Revenue Service has consistently adhered to the doctrine of intergovernmental tax immunity and the provisions of the Public Salary Tax Act of 1939 by recognizing that the part of *current* pension payments received by state and local retirees, which is attributable to employer contributions for years prior to 1939, is exempt from the federal income tax in accordance with the requirements of the Act. *See* Rev. Rul. 56-82, 1956-1 C.B. 59; Rev. Rul. 57-75, 1957-1 C.B. 28.

Similar to its claimed reliance interests, Virginia's equitable claims are grossly exaggerated. The refund right implicated here arises under the state's general individual income tax. Under that tax, just like the federal income tax, it is every citizen's right to avoid the tax in the first instance. As observed by Judge Learned Hand in a famous dissent:

> Over and over again courts have said that there is nothing sinister in so arranging one's affairs as to keep taxes as low as possible. Everybody does so, rich or poor, and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.

Commissioner v. Newman, 159 F.2d 848, 850-51 (2d Cir.), *cert. denied*, 331 U.S. 859 (1947). It is a strange conception of equity which would permit the State to single out these claimants and deny them refunds on equitable grounds for an unlawful tax, when all other individual taxpayers of the state are free to arrange their affairs to avoid or minimize lawful taxes in the first instance.

Virginia's claims of fiscal burden demonstrate nothing. The State routinely processes and awards in excess of 1.5 million refund claims annually. For example, in the fiscal year ended July 1, 1988, the State paid 1,780,498 taxpayer refund claims, totalling $360 million. *See Virginia Department of Taxation Annual Report, Fiscal Year 1988*, at 11.[19] (App. G at 25a). The State identifies no principle, and *amicus* submits that there is none, which permits the State to single out the petitioners for the purpose of balancing its budget, particularly, where no other individual taxpayer has been required to do so.

[19] This amount is understated since individual taxpayers may, by adjustment of withholding and/or estimated tax payments, to a large extent self-administer their own *de facto* refunds in accordance with their own tax planning.

In addition, in its defense of this case, the State has conveniently ignored the additional "general fund individual income tax *windfall*" that it has realized as the result of the *unforeseen* revenue enhancement provided to the state by virtue of its piggyback adoption of the Federal Tax Reform Act of 1986. At the time this case was tried, this individual income tax *windfall* was estimated to provide the state with unanticipated additional individual income tax revenues of over $175 million between fiscal year 1988 and fiscal year 1990. *See Virginia Department of Taxation Annual Report Fiscal Year 1989* at 5. (App. G at 26a). Viewed objectively, Virginia's claim of inequity amounts to nothing more than the fact that its legislature made the political choice in 1989 to maintain its ranking as the fifth lowest tax burden in the United States by enacting an additional tax cut of $156.1 million (J.A. 28) and attempting to finance that political choice by extinguishing the meritorious claims of the petitioners. *See Virginia Department of Taxation Annual Report Fiscal Year 1991*, at 12. (App. G at 26a).

The court below also did not take into account the windfall that Virginia received during the forty-plus years this unlawful scheme was in effect.[20] Common sense suggests that the amount of taxes exacted for years before 1985 exceeds by several times any present refund obligation. Second, Virginia did not hesitate to accept that part of the Public Salary Tax of 1939 which benefitted its parochial interests. Under Title II of the Act, Virginia's retirees, as well as its then current employees, enjoyed total immunity from the federal income tax for all years prior to 1939. (App. B at 9a-12a). Some of its

[20] The court also did not consider the fact that Virginia's economy for years has been the beneficiary of a generous federal government. Recent statistical data reflect that in fiscal year 1989, the Department of Defense, alone, spent over $15 billion in the state. *See* Department of Defense ATLAS/DATA ABSTRACT FOR THE UNITED STATES AND SELECTED AREAS—FY 1989. (App. H at 29a).

citizens presently continue to enjoy that benefit. *See* note 18, *supra*. Having accepted the benefits of the Act, including its limited waiver of immunity, equity compels that Virginia now accept its burden. *Cf. Fahey v. Mallonee*, 332 U.S. 245 (1947) (one may not retain the benefits of an act while attacking its constitutionality).

In addition, the court failed to analyze the equities and reliance interests of the federal retirees, many of whom are elderly. The taxpayers here are not sophisticated multi-state business enterprises. They are average, law-abiding citizens who complied with the mandates of the Virginia law. For purposes of weighing the equities, they should not now be penalized by Virginia for complying with its laws and placing their trust in the political process. *Cf. Quill Corp. v. North Dakota*, 112 S. Ct. 1904, 1922 (1992) (White, J., dissenting) ("[W]e should insist that the appropriate way to challenge a tax as unconstitutional is to pay it . . . and then sue for declaratory judgment and refund."). Nor is it appropriate to deny these citizens their rights because they could not afford or risk the panoply of sanctions the State imposes for a refusal to comply with its tax laws. *See McKesson*, 496 U.S. at 38 n.21 (1990) ("[W]hen a tax is paid in order to avoid financial sanctions . . . the tax is paid under 'duress' . . . .").[21]

Moreover, it is totally inappropriate for a court to penalize an elderly citizen because that citizen could not afford to challenge that which the State should have known

[21] Individual income taxpayers who fail to comply with Virginia's income tax laws are subject to both civil and criminal sanctions. *See, e.g.*, Code §§ 58.1-347, 58.1-348, 58.1-350, 58.1-351, 58.1-496. (App. E at 19a-22a). The respondent takes great pride in its aggressive enforcement and audit programs. *See, e.g., Virginia Department of Taxation Annual Report 1989*, at 15 (noting that FY89 audit assessments were $10.7 million above the prior year). (App. G at 26a).

was, at best, suspect.[22] Indeed, even if Virginia's position otherwise had merit, these citizens should not be denied their federal rights. *Cf. Owen v. City of Independence*, 445 U.S. 622, 655, *reh'g denied*, 446 U.S. 993 (1980) ("Thus, even where some constitutional development could not have been foreseen . . . it is fairer to allocate any resulting financial loss to the inevitable costs of government borne by all taxpayers, than to allow its impact to be felt solely by those whose rights, albeit newly recognized, have been violated.").[23]

With respect to Virginia's 1989 tax collections after this Court's announcement of *Davis*, the legislature, consistent with the rule of *Welch v. Henry*, 305 U.S. 134, *reh'g denied*, 305 U.S. 675 (1938), had the ability to remedy the discrimination for taxes first due and returnable on May 1, 1989 on 1988 income. It consciously chose to defer the equalization of treatment for a year. (J.A. 28). Having waived the right to cure this part of the inequity, in no event should the State be permitted to retain the taxes first due on May 1, 1989 on 1988 income. *See R.H. Stearns Co. v. United States*, 291 U.S. 54, 61 (1934) (" 'He who prevents a thing from being done may not avail himself of the nonperformance which he has himself occasioned. . . .' ") (citation omitted).

[22] *See* Section of Taxation REPORT TO HOUSE OF DELEGATES, August, 1990 at 2 (noting that for years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. (App. I at 30a). *Cf.* Shaviro, *An Economic and Political Look at Federalism in Taxation*, 90 Michigan L. Rev. 895, 924 (1992) ("[State] audits typically . . . tend to be influenced more by political and budgetary considerations . . . often take the form of nonspecific denials . . . requiring voluminous [taxpayer] documentation in response—and are conducted very much in light of the taxpayer's expected unwillingness to litigate . . . .").

[23] The court below also ignored that these citizens insured that their interests were advocated as an *amicus* before this Court in *Davis*. *See Davis*, 489 U.S. at 805.

The Supreme Court of Virginia's analysis of the equities also manifests a lack of understanding of the uniqueness of the personal income tax. Most states have long since adopted the federal standard of equity and conscience which favors the taxpayer. *See, e.g., Hackman v. Director of Revenue*, 771 S.W.2d 77 (Mo. 1989) (banc), *cert. denied*, 493 U.S. 1019 (1990); *Kuhn v. State, Dep't of Revenue*, 817 P.2d 101 (Colo. 1991), *cert. dismissed*, 112 S. Ct. 1925 (1992). This standard has its genesis in several of this Court's decisions involving federal taxation. As noted in *George Moore Ice Cream Co. v. Rose*, 289 U.S. 373 (1933), "[a] high-minded Government renounced an advantage that was felt to be ignoble, and set up a new standard of equity and conscience." *Id.* at 379. This standard expressly rejects such "ignoble" concepts as payment under protest, the power of the sovereign to retain invalid exactions, and the power to qualify the refund right by prospective decisions. Moreover, the federal refund right is conditioned or limited *solely* by the statute of limitations. The breadth of this right was described in *Jones v. Liberty Glass Co.*, 332 U.S. 524 (1947), *reh'g denied*, 333 U.S. 850 (1948):

> [W]e read the word 'overpayment' in its usual sense, as meaning any payment in excess of that which is properly due. Such an excess payment may be traced to an error in mathematics or in judgment or in interpretation of facts or law. And the error may be committed by the taxpayer or by the revenue agents. *Whatever the reason*, the payment of more than is rightfully due is what characterizes an overpayment.

Id. at 531 (emphasis added). It includes the right to recover " 'erroneously,' 'illegally,' or 'wrongfully' collected taxes." *United States v. Dalm*, 494 U.S. 596, 610 n.6, *reh'g denied*, 495 U.S. 941 (1990). This standard is based on sound considerations of public policy and seeks as its end to promote compliance with the income tax system. *See, e.g.*, REPORT AND RECOMMENDATIONS ON TAXPAYER

COMPLIANCE, American Bar Association Commission on Taxpayer Compliance, July, 1989, 41 Tax Lawyer 329 (1988).

Virginia's scheme of personal income taxation "piggybacks" on the federal scheme of taxation. Virginia has adopted the provisions of the Internal Revenue Code as the substantive state tax law, subject to limited statutory modifications. *See* Code §§ 58.1-322; 58.1-301 (App. E at 17a). In addition, the state refund right is not conditioned by a payment under protest provision and merely requires the timely filing of a refund claim. *See* Code §§ 58.1-1823; 58.1-1824; Reg. Sec. 630-2-499 D. (App. E at 18a-19a, 22a). Virginia's scheme of personal income taxation expressly grants its citizens the right to claim and receive refunds of Virginia income taxes which are attributable to intervening developments under the Internal Revenue Code. *Id.* Moreover, the period within which a refund may be claimed provides for an extended period of limitations where there is a change in the taxpayer's underlying federal income tax liability. *Id.* Indeed, in this case the State has waived all procedural bars to refunds. *See* Code § 58.1-1823B. (App. E at 18a).

Contrary to the decision below, the reliance and equitable interests of Virginia are meager. By virtue of its piggyback scheme of taxation, Virginia has expressly rendered its tax scheme subject to a host of unanticipated events, including unforeseen and unanticipated developments in the administrative rules of the Internal Revenue Service, enactments of Congress and federal decisional law. *See* Code § 58.1-301. (App. E at 17a). Stated another way, the unforeseen is an integral and anticipated element of the Virginia personal income tax law. Consequently, the contentions of the respondent below that the state refund right could be denied in this case because the refund liability was unforeseen is without merit.

Moreover, the decision of the court below to qualify the petitioners' refund rights under state law raises an in-

dependent constitutional ground for invalidating the decision. Here, the petitioners, who are seeking to enforce a constitutional right, are being required to satisfy and defeat the condition of the prospectivity defense, a condition not otherwise imposed on other Virginia income taxpayers.[24]

The petitioners' refund right cannot be subject to a defense based on the origin of the claim—the Constitution, when other Virginia income taxpayers' refund rights based on state law are not subject to or qualified by the defense. *See McKnett v. St. Louis & S.F. Ry. Co.*, 292 U.S. 230, 234 (1934) ("A state may not discriminate against rights arising under federal laws."). *See also Ward v. Board of County Comm'rs*, 253 U.S. 17, 22 (1920) (holding that a taxpayer could not be denied a tax refund on "non-federal grounds of decision that were without any fair or substantial support.").

Contrary to the impassioned plea of Virginia, none of the seven states (i.e., Missouri, New Mexico, West Virginia, Michigan, Louisiana, Colorado, Oregon) who have complied with their obligations to pay refunds in the wake of *Davis* has suffered the untoward results suggested by Virginia. Equity cannot excuse Virginia's obligation to pay the petitioners the refunds to which they are entitled. *See Patterson v. Shumate*, 112 S. Ct. at 2250.

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[24] For example, another taxpayer may challenge an item of federal adjusted gross income and by final judgment or settlement establish a new principle of law under the Internal Revenue Code. *See, e.g., Cottage Sav. Ass'n v. Commissioner*, 111 S. Ct. 1503 (1991). At the federal level, the taxpayer is entitled to a refund "whatever the reason." *Jones*, 332 U.S. at 531. That same taxpayer would then automatically be entitled to a refund of the Virginia tax attributable to that piggybacked item of income and, as a matter of Virginia law, could not be subject to the prospectivity defense, even if all the tests of the prospectivity defense were otherwise satisfied. *See* Reg. Sec. 630-2-499 D. Indeed, such a taxpayer would receive the benefit of an extended statute of limitations to make the claim. *Id.*

CONCLUSION

For the reasons set forth above, the court below erred in failing to enforce 4 U.S.C. § 111 in accordance with terms. Since the taxes collected by Virginia could "not be exacted," *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 387 (1960), in violation of the federal retirees' immunity and are therefore "void." *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961), and since the State has taken no steps to remedy the unlawful tax, *amicus* urges that, as a matter of federal law, "to the extent [petitioners have] paid taxes pursuant to this invalid tax scheme, [they are] entitled to a refund." *See Davis*, 489 U.S. at 817; *Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239, 247 (1931). Accordingly, *amicus* respectfully urges that the decision below be reversed and the case be remanded to the court below with instructions to order refunds as authorized under Code § 58.1-1823B. (App. E at 18a).

Respectfully submitted,

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July 16, 1992

APPENDICES

APPENDIX A

MEMBERS OF THE MILITARY COALITION

THE RETIRED OFFICERS ASSOCIATION (TROA)

The Retired Officers Association was founded in 1929 and has approximately 376,000 members. Membership in the Association is open to all past and present, active, reserve and retired commissioned and warrant officers in any of the seven uniformed services. The organization's mission is to support strong national defense and to represent membership on retirement and benefit issues before Congress.

AIR FORCE ASSOCIATION (AFA)

The Air Force Association was founded in 1946 and has approximately 200,000 members. Membership is open to anyone who has served in the U.S. armed forces. Other American citizens may affiliate as patrons. The organization's mission is to promote public understanding of aerospace issues and national security requirements to ensure strong support of the nation's defense and the men and women who serve in the U.S. Air Force.

AIR FORCE SERGEANTS ASSOCIATION (AFSA)

The Air Force Sergeants Association was founded in 1961. It has approximately 161,000 members and is composed of active and retired enlisted personnel in the Air Force, Air National Guard, Air Force Reserve, Army Air Corps and Army Air Force. Its members belong to 198 chapters throughout the world and the purpose of the organization is to serve as the voice of Air Force enlisted service members.

ASSOCIATION OF MILITARY SURGEONS OF THE UNITED STATES (AMSUS)

The Association of Military Surgeons of the United States received its Congressional Charter in 1908. Its membership consists of 17,000 members and is open to all

past and present commissioned officers or GS-9 and above civilians in the medical services of the United States Air Force, the United States Air Force Reserve, the United States Army, the United States Army Reserve, the Air National Guard, the Army National Guard, United States Navy, United States Navy Reserve, United States Coast Guard, the United States Public Health Service and the Veterans' Administration; officers of military medical services of other nations; and past and present medical consultants to the chiefs of the federal medical services. The purpose of the Association is to improve the nation's federal health care system.

ASSOCIATION OF U.S. ARMY (AUSA)

The Association of U.S. Army was founded in 1950 and has approximately 150,000 individual and 250 industrial members. Membership is open to all active, reserve and civilian personnel in the Army, and any person subscribing to the association's bylaws. The purpose of the organization is to foster public understanding and support of the Army and the people who serve in it.

CHIEF WARRANT AND WARRANT OFFICERS ASSOCIATION, U.S. COAST GUARD (CW & WOA)

The Chief Warrant and Warrant Officer's Association was founded in 1929 and has approximately 3,300 members. Membership is open to active duty, reserve and retired Coast Guard warrant and chief warrant officers. The association's purpose is to advance members' professional abilities.

COMMISSIONED OFFICERS ASSOCIATION OF THE U.S. PUBLIC HEALTH SERVICE, INC. (COA)

The Commissioned Officers Association of the U.S. Public Health Service was founded in 1937 and has approximately 7,000 members. Membership is open to active duty, retired, inactive reserve and former commissioned officers of the U.S. Public Health Service. The purpose of the organization is to ensure that the interests and welfare of commissioned officers of the USPHS are protected.

ENLISTED ASSOCIATION OF THE NATIONAL GUARD OF THE U.S. (EANGUS)

The Enlisted Association of the National Guard of the U.S. was founded in 1962 and has approximately 60,000 members. Membership is open to enlisted members of the National Guard through state associations and associate membership is open to all individuals through state associations. The purpose of the association is to promote and maintain adequate national security; and to foster the status, welfare and professionalism of enlisted members of the National Guard.

FLEET RESERVE ASSOCIATION (FRA)

The Fleet Reserve Association was founded in 1922. It has approximately 150,000 members who are active duty, retired enlisted personnel and commissioned officers with prior enlisted service in the Navy, Marine Corps and Coast Guard. The Association is chartered under the laws of Pennsylvania and its purpose is to represent its members on military personnel legislative matters before Congress.

MARINE CORPS LEAGUE (MCL)

The Marine Corps League was founded in 1923 and has approximately 31,000 members. Membership is open to those who served in the Marine Corps. The organization's mission is to preserve the traditions, to promote the interests of the Marine Corps, to voluntarily aid and render assistance to all Marines and former Marines, as well as to their widows and orphans.

MARINE CORPS RESERVE OFFICERS ASSOCIATION (MCROA)

The Marine Corps Reserve Officers Association was founded in 1928 and has approximately 5,500 members.

Membership is open to all Marine officers and officers of other U.S. services who served with Marines. The association's mission is to support and strengthen the Marine Corps, its reserve and reserve officers.

NATIONAL ASSOCIATION FOR UNIFORMED SERVICES/SOCIETY OF MILITARY WIDOWS (NAUS/SMW)

The National Association for Uniformed Services/ Society of Military Widows was founded in 1968 and has approximately 72,000 members. NAUS/SMW membership is open to all active, retired and former members of the uniformed services, their families and survivors. The association's mission is to represent members' interests by supporting legislation that upholds the security of the United States, sustains the morale of the uniformed services and provides fair and equitable consideration for all.

NATIONAL GUARD ASSOCIATION OF THE UNITED STATES (NGAUS)

The National Guard Association of the U.S. was founded in 1878 and has approximately 56,000 members. Membership is open to all present and former officers of the Army and Air National Guard, corporate and individual associate membership. The association's mission is to improve the readiness of the National Guard and to provide personnel benefits and entitlements for the half million members of the National Guard.

NATIONAL MILITARY FAMILY ASSOCIATION (NMFA)

The National Military Family Association was founded in 1969 and has approximately 6,250 members. Membership is open to active duty, retired and reserve component members of the seven uniformed services and their family members. The association's mission is to serve as an advocate for uniformed service families and to educate and inform them concerning issues affecting their lives.

NAVAL ENLISTED RESERVE ASSOCIATION (NERA)

The Naval Enlisted Reserve Association was founded in 1957. It has 16,000 members and its membership is open to active, inactive, and retired enlisted reservists in the Navy, Marine Corp and Coast Guard. The Association's mission is to focus on members' interests, morale and well-being, and readiness and training of sea service reserve forces.

NAVAL RESERVE ASSOCIATION (NRA)

The Naval Reserve Association was founded in 1954 and consists of 24,000 members. Membership in the Naval Reserve Association is open to active, inactive and retired Naval Reserve officers and its purpose is to maintain and strengthen the nation's defense by ensuring a continued strong Navy and Naval Reserve.

NAVY LEAGUE OF THE UNITED STATES (NLUS)

The Navy League of the United States was founded in 1902 and has approximately 75,000 members. Membership is open to civilians, military reservists and retirees. The league's mission is to maintain a strong U.S. maritime posture through support of the Navy, Marine Corps, Coast Guard and Merchant Marine.

NON COMMISSIONED OFFICERS ASSOCIATION OF THE UNITED STATES (NCOA)

The Non Commissioned Officers Association of the United States is a patriotic, civic and fraternal organization operating under Texas Corporate Charter. The Association was founded in 1960 and has more than 160,000 members. Its membership consists of active, reserve, retired or veterans of the United States armed forces in the grades E-4 thru E-9. The purpose of the Association is to promote and protect the rights and benefits of active duty and veteran non commissioned officers and petty officers in all five branches of the armed forces, and pro-

vide opportunities for them to join in patriotic, fraternal, social and benevolent activities.

RESERVE OFFICERS ASSOCIATION OF THE UNITED STATES (ROA)

The Reserve Officers Association of the United States was organized in 1922, and chartered by Congress in June 1950. Originally, the Reserve Officers Association consisted solely of Army Officers, Reserve Officers, National Guard Officers, and Retired Officers. Following World War II, the Reserve Officers Association expanded its membership to all services and it now has approximately 120,000 members. The purpose of the Association is to ensure an adequate total force of all services, including active and reserve components, and a force that is mobilization ready to meet any contingency.

THE JEWISH WAR VETERANS OF THE UNITED STATES OF AMERICA (JWV)

The Jewish War Veterans of the United States was founded in 1896 and has approximately 100,000 members. Membership is open to veterans of war time service of the Jewish faith. The organization's mission is service to veterans, Americanism, and to provide a voice on the Hill for veterans' legislation and benefits.

THE MILITARY CHAPLAINS ASSOCIATION (MCA)

The Military Chaplains Association was founded in 1925 and chartered by the 81st Congress in 1950. It has approximately 1,300 members. Membership is open to all chaplains of the Army, Navy, Air Force, VA and Civil Air Patrol, active duty, reserve, retired and former. The organization's mission is to safeguard and strengthen the forces of faith and morality of our nation; to perpetuate and to deepen the bonds of understanding and friendship in our military services; to preserve spiritual influence and interest in all members and veterans of the armed

forces; to uphold the Constitution of the United States; and to promote justice, peace and goodwill.

THE RETIRED ENLISTED ASSOCIATION (TREA)

The Retired Enlisted Association was founded in 1968 and consists of 50,000 members. Its membership is made up of enlisted retirees from all branches of the armed services and their surviving spouses. The mission of the association is to represent retired enlisted personnel and protect retiree military benefits.

U.S. ARMY WARRANT OFFICERS ASSOCIATION (USAWOA)

The U.S. Army Warrant Officers Association was founded in 1973 and has 4,000 members. Its members consist of National Guard active duty, reserve and retired Army warrant officers. The purpose of the association is to recommend improvement of the Army, and promote technical and professional information among warrant officers.

U.S. COAST GUARD CHIEF PETTY OFFICERS ASSOCIATION (CPOA)

The U.S. Coast Guard Chief Petty Officers Association was founded in 1969. Its 9,000 members are active, retired, and reserve Coast Guard chief petty officers. The mission of the Association is to promote the welfare of chief petty officers, to promote and protect the rights and benefits of all armed forces personnel and aid in Coast Guard recruiting.

APPENDIX B

PUBLIC SALARY TAX ACT OF 1939

AN ACT

Relating to the taxation of the compensation of public officers and employees.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled, That this Act may be cited as the "Public Salary Tax Act of 1939".

TITLE I

SECTION 1. Section 22(a) of the Internal Revenue Code (relating to the definition of "gross income") is amended by inserting after the words "compensation for personal service" the following: ("including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing)".

SEC. 2. Section 116(b) of the Internal Revenue Code (exempting compensation of teachers in Alaska and Hawaii from income tax) is repealed.

SEC. 3. Section 22(a) of the Internal Revenue Code is amended by adding at the end thereof a new sentence to read as follows: "In the case of judges of courts of the United States who took office on or before June 6, 1932, the compensation received as such shall be included in gross income".

SEC. 4. The United States hereby consents to the taxation of compensation, received after December 31, 1938, for personal service as an officer or employee of the United States, any Territory or possession of political subdivision thereof, the District of Columbia, or any

agency or instrumentality of any one or more of the foregoing, by any duly constituted taxing authority having jurisdiction to tax such compensation, if such taxation does not discriminate against such officer or employee because of the source of such compensation.

TITLE II

SEC. 201. Any amount of income tax (including interest, additions-to-tax, and additional amounts) for any taxable year beginning prior to January 1, 1938, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing—

(a) shall not be assessed, and no proceeding in court for the collection thereof shall be begun or prosecuted (unless pursuant to an assessment made prior to January 1, 1939);

(b) if assessed after December 31, 1938, the assessment shall be abated, and any amount collected in pursuance of such assessment shall be credited or refunded in the same manner as in the case of an income tax erroneously collected; and

(c) shall, if collected on or before the date of the enactment of this Act, be credited or refunded in the same manner as in the case of an income tax erroneously collected, in the following cases—

(1) Where a claim for refund of such amount was filed before January 19, 1939, and was not disallowed on or before the date of the enactment of this Act;

(2) Where such claim was so filed but has been disallowed and the time for beginning suit with respect thereto has not expired on the date of the enactment of this Act;

(3) Where a suit for the recovery of such amount is pending on the date of the enactment of this Act; and

(4) Where a petition to the Board of Tax Appeals has been filed with respect to such amount and the Board's decision has not become final before the date of the enactment of this Act.

SEC. 202. In the case of any taxable year beginning after December 31, 1937, and before January 1, 1939, compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall not be included in the gross income of any individual under Title I of the Revenue Act of 1938 and shall be exempt from taxation under such title, if such individual either—

(a) did not include in his return for a taxable year beginning after December 31, 1936, and before January 1, 1938, any amount as compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing; or

(b) did include any such amount in such return, but is entitled under section 201 of this Act to have the tax attributable thereto credited or refunded.

SEC. 203. Any amount of income tax (including interest, additions to tax, and additional amounts) collected on, before, or after the date of the enactment of this Act for any taxable year beginning prior to January 1, 1939, to the extent attributable to compensation for personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, shall be credited or refunded in the same manner as in the case of an income tax erroneously collected, if claim for refund with respect thereto is filed after January 18, 1939, and

the Commissioner of Internal Revenue, under regulations prescribed by him with the approval of the Secretary of the Treasury, finds that disallowance of such claim would result in the application of the doctrines in the cases of Helvering against Therrell (303 U.S. 218), Helvering against Gerhardt (304 U.S. 405), and Graves et al. against New York ex rel O'Keefe, decided March 27, 1939, extending the classes of officers and employees subject to Federal taxation.

SEC. 204. Neither section 201 nor section 203 shall apply in any case where the claim for refund, or the institution of the suit, or the filing of the petition with the Board was, at the time filed or begun, barred by the statute of limitations properly applicable thereto.

SEC. 205. Compensation shall not be considered as compensation within the meaning of sections 201, 202, and 203 to the extent that it is paid directly or indirectly by the United States or any agency or instrumentality thereof.

SEC. 206. The terms used in this Act shall have the same meaning as when used in Chapter 1 of the Internal Revenue Code.

SEC. 207. No collection of any tax (including interest, additions to tax, and penalties) imposed by any State, Territory, possession, or local taxing authority on the compensation, received before January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof which is exempt from Federal income taxation and, if a corporate agency or instrumentality, is one (a) a majority of the stock of which is owned by or on behalf of the United States, or (b) the power to appoint or select a majority of the board of directors of which is exercisable by or on behalf of the United States, shall be made after the date of the enactment of this Act.

SEC. 208. This title shall not apply with respect to any officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing, after the Secretary of the Treasury has determined and proclaimed that it is the policy of such State to collect from any individual any tax, interest, additions to tax, or penalties, on account of compensation received by such individual prior to January 1, 1939, for personal service as an officer or employee of the United States or any agency or instrumentality thereof. In making such determination the Secretary of the Treasury shall disregard the taxation of officers and employees of any corporate agency or instrumentality which is not exempt from Federal income taxation, or which if so exempt is one (a) a majority of the stock of which is not owned by or on behalf of the United States and (b) the power to appoint or select a majority of the board of directors of which is not exercisable by or on behalf of the United States.

SEC. 209. In the case of the judges of the Supreme Court, and of the inferior courts of the United States created under article III of the Constitution, who took office on or before June 6, 1932, the compensation received as such shall not be subject to income tax under the Revenue Act of 1938 or any prior revenue Act.

SEC. 210. For the purposes of this Act, the term "officer or employee" includes a member of a legislative body and a judge or officer of a court.

SEC. 211. If either title of this Act, or the application thereof to any person or circumstances, is held invalid, the other title of the Act shall not be affected thereby.

Approved, April 12, 1939.

APPENDIX C

OPINION OF ARIZONA ATTORNEY GENERAL
No. 60-9-L (1959)

December 28, 1959

Honorable David S. Wine
State Senator
Arizona State Senate
Phoenix, Arizona

Dear Senator Wine:

In response to your request regarding an opinion on the following question:

> "Is retirement compensation received by Federal Civil Service employees subject to the Arizona State income tax?",

it is the opinion of the Attorney General's office that said retirement compensation is subject to the Arizona State income tax.

It is our belief that federal civil service retirement income falls under that part of A.R.S. § 43-112(a), which is:

> "compensation for personal service, including personal service as an officer or employee of this state or the federal government, or any political division thereof or any agency or instrumentality of any one or more of the foregoing, * * *"

A.R.S. § 43-112(b) sets forth specifically all forms and types of income which are excluded from Arizona State income tax and federal retirement compensation does not fall thereunder.

In addition to the statutes above set forth, the Arizona State Tax Commission, in its Income Tax Regulation,

§ 112 (a)-2, has specifically included such retirement compensation as follows:

> "§ 112 (a)-2. *Compensation for Personal Services.*
>
> (a) Commissions paid salesmen, compensation for services on the basis of a percentage of profits, commissions on insurance premiums, tips, pay of persons in the military or naval forces of the United States, retired pay of Federal and other officers, and pensions or retiring allowances paid by the United States (unless expressly exempt) * * * "

Since, by federal statute, civil service employees must contribute to their retirement compensation fund, it is the opinion of the State Tax Commission and this office concurs, that the retired federal civil service employees need not pay any Arizona State Income Tax on his retirement compensation received, until he receives back from the retirement fund a sum equal to that amount which he has contributed. Once he has received back a sum equal to what he had contributed, then thereafter all said income is wholly taxable. This situation is treated much the same as annuities are treated under our Arizona statutes. A.R.S. § 43-112 (b) (3).

If you have any further question, please feel free to contact this office.

Very truly yours,

WADE CHURCH
The Attorney General

STANLEY E. GOODFARB
Assistant Attorney General

SZG: bh

APPENDIX D

EXCERPTS FROM THE REPORT OF THE HOUSE FINANCE RETIREMENT SUBCOMMITTEE

To

THE GOVERNOR AND THE GENERAL ASSEMBLY OF VIRGINIA

DECEMBER, 1982

* * * *

The subcommittee was directed by Delegate Morrison to study the issue of desirability and feasibility of any possible changes in the treatment of retirement income for state individual income tax purposes. The subcommittee was to examine in particular the individual income tax treatment of military and civil service retirement benefits. The chairman also requested the subcommittee to examine the current Virginia retirement income tax credit. (pg. 4)

* * * *

Although further differences in treatment among the different classes of retirees can be listed, tax laws should not distinguish the components of compensation and why a person chooses a specific benefit package from another. The goal of the tax structure is to simply treat taxpayers fairly based on the benefits and income that they receive which, of course, they chose on their own. (pg. 8)

* * * *

The subcommittee has thoroughly explored the present treatment of retirement benefits in Virginia as well as the treatment of retirement benefits in other states. Moreover, the subcommittee has considered the concerns of numerous groups of retirees at a hearing held during the course of the study. (pg. 23)

* * * *

The subcommittee believes that to cure this inequity all retirees, age 62 and over, should be provided an exclusion of the first $3,000 of retirement benefits reduced by social security or any other non taxable retirement benefits. (pgs. 24-25)

* * * *

APPENDIX E

EXCERPTS FROM THE VIRGINIA INCOME TAX LAW AND REGULATIONS

Sec. 58.1-301. Conformity of terms to Internal Revenue Code.—A. Any terms used in this chapter shall have the same meaning as when used in a comparable context in the laws of the United States relating to federal income taxes, unless a different meaning is clearly required.

B. Any reference in this chapter to the laws of the United States relating to federal income taxes shall mean the provisions of the Internal Revenue Code of 1954, and amendments thereto, and other provisions of the laws of the United States relating to federal income taxes, as the same may be or become effective at any time or from time to time.

Sec. 58.1-322. Virginia taxable income of residents.—A. The Virginia taxable income of a resident individual means his federal adjusted gross income for the taxable year, which excludes combat pay for certain members of the Armed Forces of the United States as provided in § 112 of the Internal Revenue Code, as amended, and with the modifications specified in this section.

* * * *

D. In computing Virginia taxable income there shall be deducted from federal adjusted gross income:

1.a. The amount allowable for itemized deductions for federal income tax purpose where the taxpayer has elected for the taxable year to itemize deductions on his federal return, but reduced by the amount of income taxes imposed by the Commonwealth or any other taxing jurisdiction and deducted on such federal return and increased by an amount which, when added to the amount deducted under § 170 of the Internal Revenue Code for mileage, results

in a mileage deduction at the state level for such purposes at a rate of eighteen cents per mile; or

• • • •

Sec. 58.1-1823. Reassessment and refund upon filing of amended return.—A. Any person filing a tax return required for any tax administered by the Department of Taxation may, within three years from the last day prescribed by law for the timely filing of the return, or within sixty days from the final determination of any change or correction in the liability of the taxpayer for any federal tax upon which the state tax is based, whichever is later, file an amended return with the Department. If the Department is satisfied, by evidence submitted to it or otherwise, that the tax assessed and paid upon the original return exceeds the proper amount, the Department may reassess the taxpayer and order that any amount excessively paid be refunded to him. The Department may reduce such refund by the amount of any taxes, penalties and interest which are due for the period covered by the amended return, or any past-due taxes, penalties and interest which have been assessed within the appropriate period of limitations. Any order of the Department denying such reassessment and refund, or the failure of the Department to act thereon within three months shall, as to matters first raised by the amended return, be deemed as assessment for the purpose of enabling the taxpayer to pursue the remedies allowed under this chapter.

Sec. 58.1-1823B.*—Notwithstanding the time limitation contained in subsection A, an amended individual income tax return claiming a refund for taxes paid with respect to retirement or pension benefits received from a federal retirement system created by the federal government for any officer or employee of the United States, including the United States Civil Service, the United States Armed Forces, or any agency or subdivision thereof for any taxable year beginning on or after January 1, 1985, may be filed within one year from the entry of a final judicial

order of a court of competent jurisdiction not subject to further appeal resolving the issue of the application to Virginia income tax law of the United States Supreme Court decision in the case of *Davis v. Michigan Department of the Treasury*, 57 U.S.L.W. 4389 (U.S. March 28, 1989).

* As enacted by Senate Bill 2 (Chapter 1—1989 Special Session No. 2) and House Bill 2 (Chapter 2—1989 Special Session No. 2).

Sec. 58.1-1824. Protective claim for refund.—Any person who has paid an assessment of taxes administered by the Department of Taxation may preserve his judicial remedies by filing a claim for refund with the Tax Commissioner on forms prescribed by the Department within three years of the date such tax was assessed. Such taxpayer may, at any time before the end of one year after the date of the Tax Commissioner's decision on such claim, seek redress from the circuit court under § 58.1-1825. The Tax Commissioner may decide such claim on the merits in the manner provided in § 58.1-1822 for appeals under § 58.1-1821, or may, in his discretion, hold such claim without decision pending the conclusion of litigation affecting such claim. The fact that such claim is pending shall not be a bar to any other action under this chapter.

• • • •

Sec. 58.1-347. Penalty for failure to file income tax returns in time.—All individual or fiduciary income tax returns required by law to be filed with the commissioner of the revenue shall be filed with the commissioner of the revenue within the time required by this chapter, unless the time for filing such returns is extended by the Department. Upon all returns on which tax is due, filed with or assessed by the commissioner of the revenue after the time herein prescribed for the filing of returns, the commissioner of the revenue shall assess a penalty equal to

six percent of the amount of taxes assessable thereon, if the failure is not more than one month, with an additional six percent for each additional month or fraction thereof during which such failure to file continues, not exceeding thirty percent in the aggregate. Such penalty shall be collected in the same manner as is provided by law for the collection of other taxes.

(As amended by Chs. 629 and 642, Laws 1989; Chs. 316 and 331, Laws 1991, both effective July 1, 1991.)
*Prior to July 1, 1991, the rate was 5%.

Sec. 58.1-348. Criminal prosecution for failure or refusal to file return of income or for making false statement therein; limitation.—Notwithstanding any other provisions of this title and in addition to any other penalties provided by law, any individual or fiduciary required under this chapter to make a return of income, who willfully fails or refuses to make such return, at the time or times required by law, or who, with intent to defraud the Commonwealth, makes any false statement in any such return, shall be guilty of a Class 1 misdemeanor. A prosecution under this section shall be commenced within five years next after the commission of the offense.

Sec. 58.1-350. Procuring returns from delinquent individuals or fiduciaries.—The commissioner of the revenue shall secure a return from every delinquent individual or fiduciary within his jurisdiction, or if any such individual or fiduciary refuses to make a return or fails to make such return for fifteen days after the commissioner of the revenue calls upon him to do so, such commissioner shall, from the best information he can obtain, make an estimate of the income of such individual or fiduciary and report the same to the Department.

The commissioner of the revenue shall have authority to assess taxes, penalties and interest upon such estimate, and such taxes, penalties and interest shall be collected in

like manner as is provided by law for the collection of state taxes.

Sec. 58.1-351. When, where and how individual income taxes payable and collectible.—Each individual and fiduciary liable for income tax shall pay the same to the treasurer of the county or city with whose commissioner of the revenue the taxpayer files his return at the time fixed by law for filing the return. The full amount of the tax payable as shown on the face of the return shall be so paid. A taxpayer may file his return and pay his tax in full in the closing days of his taxable year provided he is able to prepare a complete return.

If any payment is not made in full when due, there shall be added to the entire tax or to any unpaid balance of the tax, a penalty of six percent of the amount thereof, if the failure is not more than one month, with an additional six percent for each additional month or fraction thereof during which such failure to pay continues, not exceeding thirty percent in the aggregate. The entire tax or any unpaid balance of the tax, together with such penalty, will immediately become collectible. Interest upon such tax or any unpaid balance of the tax, and on the accrued penalty, shall be added at a rate determined in accordance with § 58.1-15, from the date the tax or any unpaid balance of the tax, was originally due until paid. In the case of an additional tax assessed by the commissioner of the revenue under the provisions of § 58.1-307, if the return was made in good faith and the understatement of the amount in the return was not due to any fault of the taxpayer, there shall be no penalty on the additional tax because of such understatement, but interest shall be added to the amount of the deficiency at a rate determined in accordance with § 58.1-15, from the time the said return was required by law to be filed until paid.

The penalty under this section shall not be applicable to any month or fraction thereof for which the [individual]

is subject to the penalty imposed under § 58.1-347. In no event shall the total amount of penalty assessed under this section and under § 58.1-347 exceed thirty percent in the aggregate.

Sec. 58.1-496. Willful failure or refusal to file declaration of estimated tax, or making false and fraudulent statement, a misdemeanor.—Any person required under this article to file a declaration of estimated tax who willfully fails or refuses to file such declaration, at the time or times required by this article and any person who, with intent to defraud the Commonwealth, makes any false statement in any such declaration, shall be guilty of a Class 1 misdemeanor.

Reg. Sec. 630-2-499. Individual refunds; crediting overpayment against estimated tax.

* * * *

D. Statute of Limitations. No refund of any overpayment shall be made except upon discovery by the department or written application of the taxpayer within three years of the due date of the return for such taxable year or within sixty days from the final determination of any change or correction in the taxpayer's liability for federal income tax, whichever is later.

APPENDIX F

EXCERPTS FROM THE INTERNAL REVENUE CODE

[Sec. 111]

SEC. 111. RECOVERY OF TAX BENEFIT ITEMS.

[Sec. 111(a)]

(a) DEDUCTIONS.—Gross income does not include income attributable to the recovery during the taxable year of any amount deducted in any prior taxable year to the extent such amount did not reduce the amount of tax imposed by this chapter.

[Sec. 164]

SEC. 164. TAXES.

[Sec. 164(a)]

(a) GENERAL RULE.—Except as otherwise provided in this section, the following taxes shall be allowed as a deduction for the taxable year within which paid or accrued:

(1) State and local, and foreign, real property taxes.

(2) State and local personal property taxes.

(3) State and local, and foreign, income, war profits, and excess profits taxes.

(4) The GST tax imposed on income distributions.

(5) The environmental tax imposed by section 59A.

In adidtion, there shall be allowed as a deduction State and local, and foreign, taxes not described in the preceding sentence which are paid or accrued within the taxable year in carrying on a trade or business or an ac-

tivity described in section 212 (relating to expenses for production of income). Notwithstanding the preceding sentence, any tax (not described in the first sentence of this subsection) which is paid or accrued by the taxpayer in connection with an acquisition or disposition of property shall be treated as part of the cost of the acquired property or, in the case of a disposition, as a reduction in the amount realized on the disposition.

APPENDIX G

EXCERPTS FROM THE VIRGINIA DEPARTMENT OF TAXATION ANNUAL REPORTS

FISCAL YEAR 1988

* * * *

	Number of Refunds Processed (cumulative totals)		Average Refund Turnaround Time *	
	1988	1987	AR's	Other Refunds
January	29,097	1,195	3 days	1 week
February	395,388	94,757	5 days	5 weeks
March	915,070	434,224	5 days	3 weeks
April	1,336,460	824,162	7 days	3 weeks
May	1,614,288	1,367,871	13 days	4 weeks
June	1,780,498	1,672,357	5 days	2 weeks

* Turnaround times reflect the number of days it took to actually process Accelerated Refunds in the Tax Department, and not necessarily the number of days it took to receive a refund.

Accelerated Refund Statistics
As of July 1, 1988

Total Refunds Issued	1,780,498
Accelerated Refunds Filed (30.5% of all refunds issued were originally filed as AR's)	543,071
Accelerated Refunds Issued (85.1% of all AR's were issued as an AR)	462,282
Accelerated Refunds Denied (14.9% of all AR's filed were denied)	80,789
AR's Later Assessed (2.1% of AR's with processed returns)	7,232
Average Refund Amount—1987	$247.00
Average Refund Amount—1988	$202.00

(pg. 11)

* * * *

FISCAL YEAR 1989

* * * *

Estimated the additional general fund individual income tax windfall resulting from the Federal Tax Reform Act of 1986. The additional windfall was estimated to be $41.7 million for fiscal year 1988, and $58.4 million and $77.5 million for fiscal year 1989 and 1990 respectively. (pg. 5)

* * * *

Audit assessments for Fiscal Year 1989 were $10,671,346 above last year's assessments. Part of this success is attributable to several new audit programs and information sharing agreements designed to encourage voluntary tax compliance and increase collections. (pg. 15)

* * * *

FISCAL YEAR 1991

* * * *

Furthermore, the department's compliance programs have helped Virginia to maintain a stable tax structure and low tax rates. The state's income tax rates for individuals and corporations have not increased since 1972, and the sales and use tax rate has only increased by .05 percent since 1968. According to a Special Report issued by the Tax Foundation in October, 1991, Virginia's state tax burden is $10.85 below the national average tax burden of $64.87 per $1,000 of income, which is tied for the fifth lowest among the states based on fiscal year 1990 estimates. This low tax burden benefits all Virginia citizens. (pg. 12)

* * * *

APPENDIX H

EXCERPT FROM DoD ATLAS—FY 1989

DoD ESTIMATED PAYROLL AND PRIME CONTRACTS BY STATE

(THOUSANDS OF DOLLARS)
FISCAL YEAR 1989

State	Civilian Pay	Military Active Duty Pay	Reserve & National Guard Pay	Retired Military Pay	Total Compensation	Civil Functions Contracts	Military Functions Contracts	Total Contracts
Alabama	789,524	588,907	222,248	498,323	2,099,002	86,857	1,305,531	1,392,388
Alaska	193,392	567,974	24,774	64,562	850,702	17,458	522,337	539,795
Arizona	304,621	589,779	71,806	527,678	1,493,684	11,368	2,835,519	2,846,887
Arkansas	136,907	199,024	71,951	255,818	663,700	38,261	331,331	369,592
California	4,012,634	6,516,801	431,083	2,952,123	13,912,641	60,595	23,064,102	23,124,697
Colorado	363,176	1,008,837	114,248	563,590	2,039,851	6,899	2,921,402	2,928,301
Connecticut	146,690	287,806	49,112	135,908	637,616	1,269	6,081,021	6,082,290
Delaware	47,157	96,153	27,281	64,451	235,042	12,283	158,753	171,036
District of Columbia	564,469	386,633	98,044	66,730	1,115,876	6,652	1,229,312	1,235,964
Florida	1,030,474	2,215,970	153,749	2,092,292	5,492,485	28,356	4,424,027	4,452,383
Georgia	1,030,707	1,731,308	271,133	740,461	3,773,609	34,357	1,829,823	1,864,180
Hawaii	639,481	1,362,357	40,274	191,892	2,234,004	8,018	570,715	578,733
Idaho	34,934	112,486	39,122	98,955	285,497	667	74,122	74,789

State	Civilian Pay	Military Active Duty Pay	Reserve & National Guard Pay	Retired Military Pay	Total Compensation	Civil Functions Contracts	Military Contracts Functions	Total Contracts
Illinois	560,533	729,495	166,545	308,140	1,764,713	30,814	1,218,287	1,249,101
Indiana	456,254	141,030	184,216	185,580	966,580	9,714	1,753,363	1,763,077
Iowa	37,837	9,297	57,692	81,894	186,720	7,897	418,013	452,910
Kansas	180,175	623,131	188,094	192,962	1,162,362	6,754	948,213	954,967
Kentucky	350,445	1,093,166	102,836	210,812	1,757,259	23,573	309,151	332,724
Louisiana	237,848	686,722	111,654	307,564	1,343,788	221,848	1,471,639	1,693,487
Maine	307,916	182,335	31,304	118,118	639,673	385	369,626	370,011
Maryland	1,378,780	898,527	142,181	537,183	2,956,671	26,381	3,844,497	3,870,878
Massachusetts	367,011	283,266	145,629	244,936	1,040,842	13,459	8,744,008	8,757,467
Michigan	367,889	188,637	114,947	213,904	885,377	10,215	1,255,716	1,265,931
Minnesota	87,736	21,762	94,021	126,551	330,070	12,787	1,761,187	1,773,974
Mississippi	312,429	379,785	89,776	234,067	1,016,057	73,868	1,160,690	1,234,558
Missouri	630,224	422,642	187,227	317,805	1,557,989	42,655	6,239,994	6,282,549
Montana	37,566	93,064	26,769	59,910	217,309	2,461	78,075	80,536
Nebraska	113,564	343,581	37,941	125,349	620,435	4,663	217,021	221,684
Nevada	54,035	226,732	19,641	226,554	526,962	36	230,112	230,148
New Hampshire	45,718	99,595	21,008	114,726	281,047	6,722	471,076	477,798
New Jersey	711,011	493,703	145,965	279,003	1,629,682	108,900	3,284,471	3,393,371
New Mexico	290,290	349,384	49,515	261,623	950,812	9,356	615,676	625,032
New York	543,499	749,795	229,372	361,520	1,884,187	5,377	6,546,787	6,552,164
North Carolina	414,439	2,258,954	116,264	671,972	3,461,629	2,414	1,101,328	1,103,742
North Dakota	51,171	224,602	25,501	26,402	327,676	1,299	120,515	121,814
Ohio	1,091,153	342,997	150,893	369,835	1,954,878	15,955	5,053,413	5,069,358
Oklahoma	651,866	696,112	120,537	337,319	1,815,834	17,706	641,409	659,115

Oregon	98,312	22,374	54,359	221,917	386,962	7,013	171,513	178,526
Pennsylvania	1,474,544	224,904	306,218	457,779	2,463,445	63,893	2,764,139	2,828,032
Rhode Island	138,917	147,628	32,271	76,878	395,694	1,130	415,354	417,484
South Carolina	595,656	1,316,068	168,103	526,418	2,606,245	22,585	545,581	568,166
South Dakota	36,369	145,977	23,540	40,741	246,627	1,759	65,667	67,426
Tennessee	190,774	201,973	108,973	397,090	898,374	30,197	1,088,248	1,118,445
Texas	1,849,868	3,258,588	319,561	2,036,072	7,264,089	126,464	9,136,350	9,262,814
Utah	632,384	135,528	98,639	108,006	974,556	13,846	958,799	982,645
Vermont	17,544	1,992	23,798	33,297	76,631	764	162,595	163,359
Virginia	3,479,351	4,154,703	184,847	1,560,075	9,378,976	37,773	5,858,975	5,896,749
Washington	879,416	1,293,047	131,083	725,181	3,028,727	46,395	2,904,660	2,951,055
West Virginia	48,764	9,694	33,283	88,868	180,605	37,775	125,665	163,440
Wisconsin	94,037	23,889	171,867	125,980	415,773	7,361	1,073,428	1,080,789
Wyoming	32,276	81,796	13,199	36,624	163,895	123	67,013	67,136
Total U.S.	27,959,767	38,220,511	5,220,511	20,590,933	92,592,669	1,365,357	118,551,260	119,916,607

Prepared by: Washington Headquarters Services Directorate for Information Operations and Reports

APPENDIX I

AMERICAN BAR ASSOCIATION
SECTION OF TAXATION

REPORT TO HOUSE OF DELEGATES

RECOMMENDATION

RESOLVED that the American Bar Association recommends to the state legislatures and municipal governing bodies of the United States that they adopt standards for state and local tax procedures that call for: (1) identical statutes of limitations for deficiencies and refunds; (2) identical interest rates for deficiencies and refunds; (3) no automatic imposition of penalties; (4) payment of disputed taxes only after the taxpayer is provided a hearing; (5) no seizure of property until after final adjudication; (6) a period of at least ninety days between the date of the deficiency notice and the date a notice of appeal is due; (7) the elimination of state fees to cover audit expenses; (8) providing taxpayers with due process; and (9) eliminating the need for taxpayers to relitigate identical legal issues in the same jurisdiction.

REPORT

For many years taxpayers have objected to perceived unfair and arbitrary treatment in compliance, assessment, and appeals of state and local taxes. When taxpayers perceive such treatment, voluntary compliance is seriously threatened. Addressing these concerns should increase respect for the tax system and improve the level of voluntary compliance.

Recent years have witnessed a significant increase in the amount of taxes raised at the state and local levels. For

example, for the twelve months ended March 1989, state and local governments collected $488.1 billion—a 6.3 percent increase over the twelve month period that ended March 1988. Increased tax revenues have resulted from tax increases (*e.g.*, rate increases, new taxes, broadening of existing tax bases) and enhanced enforcement of existing tax laws. The enhanced enforcement of state and local tax laws has increased the number of sensitive contacts between taxpayers and revenue collection agencies. The increase in contacts has heightened taxpayers' awareness of tax collection procedures. All of this has focussed discussion on the need for state tax policy makers and legislatures to give serious consideration to the procedural rights of taxpayers.

Consideration has led to very different responses. Some states have adopted procedural reforms through legislation while some states have done so through policy pronouncements from the revenue agency within the executive branch that is charged with implementing the tax laws. Further, some states have created a taxpayer advocate office, similar to the consumer advocate offices created during the 1960s and 1970s. Other differences are the ability to record interviews with auditors and the ability to sue the states. A comparison of all the laws that have passed is beyond the scope of this Report.

In September of 1988, California became the first state to adopt a taxpayers' bill of rights. California's legislation preceded the federal taxpayers' bills of rights. Subsequent to California's adoption, Arkansas, Illinois, Indiana, Kansas, Ohio, Oregon, and South Carolina also adopted taxpayer's bill of rights through legislation. Hawaii, Maryland, New York (state and city) and Texas adopted procedural reforms through policy pronouncements.

Over the years model legislation has been recommended that addressed procedural, due process and policy considerations in the state and local tax area. In addition to

these model acts endorsed by the ABA, it is appropriate to enumerate broad principles to guide state tax policy makers and legislatures.

A review of the procedural reforms adopted by thirteen states reveals that none of the thirteen states have adopted all of the principles recommended.

Specific statutory language is not recommended because it is viewed that: (i) it is almost impossible to draft language to amend or replace existing language that is in many instances scattered throughout the statutory framework of the various states; (ii) some states have already enacted certain of the recommended principles into their statutes and would find statutory language covering additional principles difficult to use; (iii) informal discussions with officials from various states and with national tax organizations reveal that they do not think that statutory language would be desirable in this circumstance; and, (iv) it would be desirable to affect the procedural tax reform process that is currently sweeping the states in a timely fashion.

PRINCIPLES

1. *Statutes of Limitations—Other than Fraud*

   State and local statutes of limitations for assessments, in cases other than those involving fraud, should be the same for deficiency assessments and refunds.

   Federal audit adjustments should open state and local income tax periods which are otherwise closed by statute only for those issues raised in the federal audit.

2. *Interest Rates*

   Interest rates for deficiencies and refunds should be the same. Interest is payment for the time value of money. It should not be imposed at a rate that punishes a taxpayer for failure to pay taxes timely. State and local efforts to encourage timely payment of taxes

and to punish non-compliance should be addressed by penalties and/or civil or criminal sanctions.

3. *Penalties*

   There should be no automatic imposition of penalties. Reasons for proposed penalties should be provided to the taxpayer by the taxing agency. The taxpayer should be given an opportunity to appeal, and penalties should be abated upon a showing by the taxpayer of reasonable cause. Penalties should not be enacted by legislatures to raise revenue—they should be designed solely to encourage compliance.

4. *Payment After Hearing*

   Taxpayers should not be required to post a bond or make a payment of a disputed tax until they have been afforded an opportunity for a hearing.

5. *Seizure of Property*

   A state or municipality should only be able to seize a taxpayer's property or levy against a taxpayer's assets after a final adjudication of the disputed amount or as a result of a jeopardy assessment where the probability of payment would be substantially reduced by the passage of time.

6. *Appeal Period*

   Taxpayers should not have to file a notice of appeal until at least ninety days have passed from the date on the notice of assessment. A reasonable period thereafter should be allowed for adequate preparation before a hearing is held and an opportunity should exist for the taxpayer to amend an appeal.

7. *Fees*

   Taxpayers should not have to pay the state or local government a fee for its expenses in auditing the taxpayers. Taxpayers should not have to pay the state

or local government's court costs or litigation fees if a taxpayer prevails in a dispute.

8. *Due Process*

Taxpayers should be afforded both an opportunity for a hearing before an independent tribunal and receive an appealable decision therefrom. Taxpayers should also have the opportunity to be represented by counsel and afforded other standards of due process like the use of discovery.

9. *Application of Decisions*

Once the highest court in a jurisdiction rules on a particular legal issue taxpayers should not have to relitigate the identical issue in the same jurisdiction.

COMMENTS ON PRINCIPLES

1. *Statutes of Limitation—Other than Fraud*

The underlying premise supporting civil statutes of limitation is that there is a period beyond which establishing the factual characteristics of a case becomes burdensome, difficult or impractical. This is, likewise, true with regard to issues arising under state and local tax laws.

Several states have statutes of limitation that allow the state and local government a longer period to assess a tax deficiency than the taxpayer has to claim a refund. This is perceived as creating an inequity, particularly when the taxpayer has not committed fraud.

In the area of taxation, the facts needed to establish the taxpayer's correct liability are generally reflected in the taxpayer's books and records. In many instances, taxpayers maintain books and records solely for the purposes of being able to substantiate prior

tax positions. Determining the period of time during which taxpayers should be required to maintain books and records is a subjective matter best left to the judgment of the legislature. However, once a taxpayer has been asked to maintain books and records and to continue being exposed to potential increases related to past tax periods, it seems only fair to require that the government also expose itself to the risk of having to refund taxes erroneously paid for a like period.

Because many states and local jurisdictions use federal taxable income or federal adjusted gross income as a starting point in determining state income or franchise taxes, a federal audit adjustment may trigger the need to file an amended state or local income tax return. Often, the federal audit adjustment is made after the statute of limitation has expired for auditing the state or local income tax return. When this occurs, the federal audit adjustment should not be used by the state or local government as an excuse to audit the taxpayer's state or local income tax return for issues other than those raised in a federal audit.

2. *Interest Rates*

Consistent with the treatment of interest applied to federal income tax deficiencies and refunds, some states and local governments apply a higher interest rate to deficiencies than they pay when taxes are refunded.

This appears to be an unjustifiable position if one accepts the premise that interest should be the payment for the time value of money. Interest should not be used to punish a taxpayer for the over- or underpayment of taxes—this is best done through penalties and other civil/criminal sanctions.

Some commentators have advanced the argument that higher interest rates are justified for deficiencies than for refunds because the state takes a credit risk with respect to the taxpayer's ability to pay the deficiency whereas the taxpayer presumably bears a smaller risk. Some taxpayers, however, are excellent credit risks, on a par with governmental bodies. It is inequitable to apply a higher interest rate to all taxpayers with deficiencies because a few are poor credit risks. If there is a question about a taxpayer's ability to pay a deficiency, seizure of property remedies are available. See comment on seizure of property, below.

3. *Penalties*

In recent years, the imposition of penalties has begun to be used as a revenue raising technique. Many tax jurisdictions automatically add penalty assessments to virtually all tax deficiencies. This is inappropriate if a taxpayer is neither notified of the reasons for the proposed penalties nor provided an opportunity to appeal such penalties. At a minimum, the tax agency should be required to have some basis for the penalty imposition. Further, penalties should be abated upon a showing of a reasonable cause.

4. *Payment After Hearing*

In many instances, taxpayers are required to post a bond or make payment of disputed taxes before being afforded an opportunity for an administrative appeal. This is inconsistent with federal income tax procedure and may often impose a severe hardship on taxpayers, especially when taxes erroneously collected from taxpayers are later refunded at below market interest rates.

5. *Seizure of Property*

Many state and local tax authorities abuse their power to seize property by exercising this power much too frequently. This power should be utilized only after

a final adjudication of the disputed amount or in instances where a designated governmental official determines that the probability of payment (*i.e.*; the collection for a deficiency) would be substantially reduced by the passage of time. The standards utilized to determine whether a jeopardy assessment is appropriate should be similar to those adopted by the federal government for purposes of the collection of federal taxes. Treasury Regulation 1.6851-1(1) (a) sets forth three conditions where a collection is in jeopardy; (i) the taxpayer is or appears to be "designing quickly" to leave the United States or go into hiding; (ii) the taxpayer is or appears to be "designing quickly" to place taxpayer's assets outside the reach of the government by removing, concealing, dissipating or transferring the assets; or, (iii) the taxpayer's financial solvency is or appears to be imperiled.

6. *Appeal Period*

A taxpayer's ability to appeal a tax assessment is basic to providing the taxpayer with due process. The regular delays encountered with mailing assessment notices and the amount of time necessary to evaluate such notices and determining whether an appeal is appropriate require that taxpayers be provided at least ninety days from the date on the assessment notice to file a notice of appeal. Shorter appeal periods often effectively eliminate any opportunity for due process.

As a related matter, once a notice of appeal is filed, taxpayers should be given time to amend such notice in order to perfect the appeal. Otherwise, a requirement that the taxpayer set forth his entire case may in some instances deprive taxpayers of the opportunity to analyze thoroughly the notice of assessment in conjunction with the taxpayer's books and records and other relevant information.

7. *Fees*

Some jurisdictions impose fees on taxpayers for expenses incurred in auditing the taxpayer and for legal costs incurred in defending tax appeals. While user fees may be an appropriate way of funding government services, it is unreasonable to charge taxpayers for the state's audit costs and it is also unreasonable to charge court costs if the taxpayer prevails in a dispute.

8. *Due Process*

Minimum standards of due process should be afforded a taxpayer when a tax is in dispute. Those standards include: (i) the opportunity to appeal an assessment before an independent tribunal; (ii) the opportunity to receive a decision from the independent tribunal which decision can then be appealed to a court; (iii) representation by counsel; (iv) the ability to call witnesses including government witnesses; and, (v) the availability of discovery to all parties.

It is believed that if the first level administrative appeal is provided by a part of an agency that has revenue collection responsibilities, then a de novo appeal should be provided to the taxpayer. In at least one jurisdiction (New York State) the revenue collection agency (*i.e.*, the Department of Taxation and Finance) cannot appeal unfavorable decisions from the Tax Appeals Tribunal to the courts. The concern is that this may have a chilling effect on the willingness of the tax tribunal to rule in favor of the taxpayer on the theory that the taxpayer can always appeal to the courts.

The burden of proof should generally be on the taxpayer, but, irrespective of who bears the burden of proof, the burden should ordinarily be met by a preponderance of the evidence.

9. *Application of Decisions*

State and local governments should establish procedures for implementing judicial resolutions of legal issues. Once the tax authority has lost a legal issue against a taxpayer, before the highest court in the state, there should exist some mechanism for ensuring that similarly situated taxpayers will not be faced with the litigation of legal issues that have already been resolved.

10. *Prospectivity*

There is a strong reluctance on the part of state and local governments to grant tax refunds when a tax has been held to be illegal or unconstitutional. Sometimes, there is a reluctance to refund taxes to the taxpayer litigant, and other times there is a reluctance to refund taxes to all similarly situated taxpayers unless those taxpayers have filed protective refund claims and/or lawsuits. The reluctance to grant refunds provides taxpayers with a disincentive to contest taxes and may serve to erode confidence in a voluntary system of tax compliance.

The issue of whether federal law requires state and local governments to provide taxpayers with retroactive relief when taxes have been exacted in violation of the commerce clause is before the U.S. Supreme Court in the case of *McKesson Corporation v. State of Florida* (October 1989 Term). While the tax authorities' reluctance to part with taxes that have been spent is understandable, the government's should either be prepared to refund taxes or they should escrow disputed taxes. However, no position is being taken on this issue, at this time, pending a review of the forthcoming Supreme Court decision.

Respectfully submitted,

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No. 91-794

IN THE

Supreme Court of the United States

October Term, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF JAMES B. BEAM DISTILLING CO. AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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INTERESTS OF AMICUS CURIAE

The Amicus Curiae is James B. Beam Distilling Co., ("Beam"), Petitioner in *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991) ("*Beam*"). Beam is in accord with the argument of Petitioner herein that this Court by its silence as to the retroactivity issue, applied its holding in *Davis v. Department of Treasury*, 489 U.S. 803 (1989) to the litigants then before it. Thus, pursuant to *Beam*, the rule in *Davis* must be applied to all other similarly situated litigants, including most obviously, Petitioners herein. However, there is yet another issue which is in need of clarification by this Court.

That is, the conduct of the State of Georgia[1] since the date this Court ruled in *Beam*, is illustrative of the extent to which the various states will go, without this Court's interpretive intervention at this stage, to avoid, indeed usurp, the retroactive application of this Court's decisions.

[1]As used herein, all references to the State of Georgia shall describe the State in its capacity as Respondent in *Beam*.

The force and effect of such usurpation is to deny Beam and other aggrieved taxpayers any relief whatsoever notwithstanding this Court's plain holdings in *Beam*, *Davis* and *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18 (1990) ("*McKesson*").

As will be more fully set forth hereinbelow, the State of Georgia has undertaken a course of conduct which is aimed at denying Beam any relief as a result of the State's unconstitutional taxing scheme. As a consequence, the State of Georgia has sought to undermine this Court's decision in *Beam* which held that Beam is entitled to retroactive treatment of this Court's decision in *Bacchus Imports, Ltd. v. Dias*, 468 U. S. 263 (1984) ("*Bacchus*").

Georgia's tactics are all the more alarming in light of its mandatory state refund statute, O.C.G.A. §48-2-35, which compels that all taxes collected pursuant to the invalid taxing scheme be returned to the taxpayers.

Without this Court's further clarification as to the remedies available to the class of litigants which are entitled to retroactive treatment of this Court's decisions, and perhaps more importantly, the state's absolute duty to actually provide a remedy, the State of Georgia and other states faced with such a duty, will fail and refuse to fulfill it. Such failure will not only exacerbate the discrimination which befell the taxpayers, but also negate entirely the force and effect of a finding of retroactivity. To utilize the remedy issue to divest the holding of substantive retroactivity of its meaning surely contravenes both *Beam* and *McKesson*.

ARGUMENT

ONCE THE QUESTION OF CHOICE OF LAW IS ANSWERED IN FAVOR OF PURE RETROACTIVITY, STATES CANNOT UNDERMINE THAT RULE BY DENYING AGGRIEVED TAXPAYERS ANY RELIEF OR BY FASHIONING A REMEDY WHICH IN APPLICATION IS PURELY PROSPECTIVE

Introduction

The pronouncement of this Court in *Beam* is clear; that is, inasmuch as the rule of law in *Bacchus* was applied to the parties then before the Court, principles of ". . . equality and *stare decisis* . . ." dictate that the rule must also be applied to all other litigants similarly situated to those in *Bacchus*. *Beam*, 111 S.Ct. at 2446. In other words, this Court applied *Bacchus* retroactively to the *Beam* litigants. It can be seen that Justice Souter, in his plurality decision in *Beam*, answered the "choice of law" question in favor of pure retroactivity. He then concluded that:

> ". . .[o]nce a rule is found to apply 'backward,' there may then be a further issue of remedies, *i.e.*, whether the party prevailing under a new rule should obtain the same relief that would have been awarded if the rule had been an old one. Subject to possible constitutional thresholds, see *McKesson Corp. v. Florida Alcoholic Beverages and Tobacco Div.*, 496 U.S. __, 110 S.Ct. 2238, 110 L. Ed. 2d 17 (1990), the remedial inquiry is one governed by state law, at least where the case originated in state court. . ." *Beam*, 111 S.Ct. at 2443.

Therefore, it is essential as to the second step of Justice Souter's analysis (the first being a determination as to the choice of law) to consult *McKesson* for purposes of determining the parameters for fashioning the appropriate remedy in light of the illegal tax. Those parameters were explained in *American Trucking Assns, Inc. v. Smith*, 496

U.S. 167 (1990) ("*American Trucking*"), wherein Justice O'Connor, speaking for the plurality, of the Court stated that:

> "Our decision today in *McKesson* makes clear that once a State's tax statute is held invalid under the Commerce Clause, *the State is obligated* to provide relief consistent with federal due process principles. [Citation omitted] *When the State comes under such a constitutional obligation, McKesson establishes that equitable considerations play only the most limited role in delineating the scope of that relief.*" (Emphasis added.) *American Trucking*, 496 U.S. at 181.

Although it is true that the Court in *McKesson* listed a number of alternative remedies which *may* comport with federal due process principles in a particular case, the Court did not even hint that that list is all inclusive, or that one of the listed examples would necessarily comply with due process requirements in its application by a state.[2] Rather, the Court on remand merely provided the state court with hypothetical remedial examples for guidance purposes only.

It is important to note that the Court in *McKesson* did not address the issue of whether or not the State of Florida had a statutory mechanism in place which mandated what the remedy would be in the event an illegal tax was collected. Rather, since the question of remedy was found to be, in the first instance, one of state law, this Court without delving into the State's statutory makeup, merely directed the lower court to ensure that the victimized taxpayers be provided with *a remedy*. It was in that context that the Court listed a number of possible remedies the state court could consider.

[2]In fact, the Court in *McKesson* at footnote 23 explained that under some circumstances the imposition of back taxation of the favored class as a remedy may be ". . . so harsh and oppressive as to transgress the constitution limitation" depending on "the nature of the tax and the circumstances in which it is laid." *McKesson*, 496 U.S. at 40.

The State of Georgia would read this Court's silence in *McKesson* as to the existence of a refund statute like the one enacted in Georgia[3] to mean that the State is free to ignore it; that notwithstanding the presence of a long-standing remedial statute which contains unequivocal, unambiguous and mandatory language, it is unrestrained by this Court's teachings. In fact, the State would construe the unanimous *McKesson* decision as meaning that it can manufacture frivolous barriers, roadblocks and procedural gamesmanship to deny Beam a remedy of any kind. This course of conduct, if allowed to persist, can produce but one result; the Court's finding of retroactivity being rendered meaningless.

Like Georgia, there has been a refusal on the part of many states to follow this Court's holdings in *Beam* and *McKesson* as they pertain to the retroactive application of a substantive determination that a taxing scheme is illegal. This refusal is manifested by the continued denial of said states to provide a meaningful backward looking remedy. The conduct of the State of Georgia since this Court decided *Beam* is but one example.

Accordingly, it is the purpose of the Amicus to urge this Court, when deciding that the substantive rule invalidating a particular tax shall be applied retroactively, to also compel the taxing state to fashion a remedy which will not have the force and effect of turning the retrospective finding on its head. Stated another way, the Amicus believes it is imperative for this Court to clearly enunciate that a state cannot circumvent a holding of retroactivity by imposing a remedy which is in practical application only prospective and which is in derogation of any applicable state statutory remedy.

[3]The State of Virginia also has in place a refund statute. See Virginia Code 1950, § 58.1-1820 *et seq*.

McKesson's Doctrine Of A Meaningful Backward Looking Remedy

Once a determination is made, as in *Beam*, that a tax is invalid, the Due Process Clause of the Fourteenth Amendment to the United States Constitution, U.S. Const. amend. XIV, § 1, obligates the State to provide "meaningful backward-looking relief to rectify any unconstitutional deprivation." *McKesson*, 496 U.S. at 31. (footnote omitted). The plaintiff in *McKesson* challenged a Florida alcohol tax scheme that was very similar to the Georgia statute in *Beam* and the Hawaii statute at issue in *Bacchus*. The state courts in both *Beam* and *McKesson* had held their respective statutes to be unconstitutional under the Commerce Clause. However, neither state court granted retrospective relief holding instead that their decisions should be given prospective application only.

In *McKesson*, however, the unanimous United States Supreme Court held:

> [If] a State penalizes taxpayers for failure to remit their taxes in a timely fashion, thus requiring them to pay first and obtain review of the tax's validity later in a refund action, the Due Process Clause requires the State to afford taxpayers a meaningful opportunity to secure postpayment relief for taxes already paid pursuant to a tax scheme ultimately found unconstitutional. *McKesson*, 496 U.S. at 22.

Although this Court in *McKesson* explained that the "State is free to choose which form of relief it will provide, so long as that relief satisfies the minimum federal requirements we have outlined . . ." *Id.* at 51, 52 (footnote omitted) it also made clear that the "State is free, of course, to provide broader relief as a matter of state law than is required by the federal Constitution." *Id.* at 52 n.36. In the case of Georgia, it did so choose by enacting O.C.G.A. § 48-2-35, its

refund statute, which requires the return of the entire tax paid rather than merely the discriminatory portion thereof.

It was significant in *McKesson* that the Florida Legislature—like the Georgia Legislature—had not provided any pre-deprivation process for the exaction of taxes, establishing instead "various sanctions and summary remedies designed so that liquor distributors tender tax payments *before* their objections are entertained and resolved." *Id.* at 38 (emphasis in original, footnote omitted). Holding the absence of a pre-deprivation process for challenging the legality of the tax to mean that Florida "requires taxpayers to raise their objections to the tax in a post-deprivation refund action[,]" the Court then held that:

> ". . . in this refund action the State must provide taxpayers with, not only a fair opportunity to challenge the accuracy and legal validity of their tax obligation, but also a 'clear and certain remedy' for any erroneous or unlawful tax collection to ensure that the opportunity to contest the law is a meaningful one." *McKesson*, 496 U.S. at 39 (footnote omitted).

The Supreme Court then held that Florida could not, consistent with the due process requirements of the Fourteenth Amendment, refuse to grant the petitioner retroactive relief in the refund proceeding.[4] The Court remanded *McKesson* to the Florida Supreme Court "for further proceedings not inconsistent with this opinion." *Id.* at 2258. Nevertheless, those remanded proceedings are still pending some two years after this Court's decision, because of the State of

[4]The Court also made clear that there is no need for the taxpayer to pay under protest where the sole remedy is a post-deprivation refund statute. *McKesson*, 496 U.S. at 38 & n.21. The language of the Georgia refund statute is consistent with this principle, because it provides that a taxpayer is entitled to a refund regardless of "whether [the taxes were] paid voluntarily or involuntarily. . . ." O.C.G.A. § 48-2-35(a).

Florida's failure to not only fashion, but implement, a refund process.

In 1991, this Court in *Beam*, remanded to the state court the issue of remedy. Those proceedings still drag on because the state continues to deny *any liability* for the years 1982, 1983 and 1984, the period to which this Court held its decision retroactively applied. It is acutely disturbing that Georgia maintains this posture since it does so in the face of its own refund statute in which its Legislature crafted a remedy which is squarely applicable here. The Georgia Legislature has chosen a backward-looking remedy that is entirely consistent with the due process requirements set out in *McKesson*.[5] Section 48-2-35(a) of the Official Code of Georgia Annotated, the refund statute, prescribes the form that Georgia's "clear and certain" remedy "shall" take. Under O.C.G.A. § 48-2-35(a), "[a] taxpayer *shall* be refunded *any and all* taxes or fees which are determined to have been erroneously or illegally assessed and collected from him under the laws of this state. . . ." (emphasis added).

Unless this Court's set of hypothetical remedies delineated in *McKesson* is to be understood as permitting a state to ignore, and hence, violate, its own statutory refund scheme in favor of one of the remedies so delineated, a full refund under Georgia's refund statute is the only "clear and certain" remedy that meets the *McKesson* standard that is available in Georgia.

[5]In fact, this case presents a stronger right to a refund than *McKesson* because the Georgia refund statute uses the mandatory "shall" while the Florida tax refund statute uses the less compelling "may". *Compare* O.C.G.A. § 48-2-35(a) *with* Fla. Stat. 215.26(1) (1990). *A fortiori* the taxpayer here is entitled to a refund. Thus, Georgia's choices in formulating the retrospective relief to which the taxpayer is entitled are more limited than the choices Florida had after *McKesson*. Furthermore, *McKesson* cannot be read as to require a state court to fashion a remedy where one already exists which comports which due process requirements.

The Georgia Legislature clearly contemplated that portions of its taxing scheme might be determined to be illegal; otherwise, the Legislature would have had no reason to enact the refund statute. The refund statute is not contingent in nature. It is not conditioned upon any act or finding other than that the tax in question was erroneously or illegally assessed or collected. Further, the statute is not elective; it is mandatory. It is not a remedy among a list of others, from which either the State or an aggrieved taxpayer may elect to implement. Nor does the statute provide an exception for the State's reliance upon a "belief" as to the legality of any particular taxing statute. To provide such an exception would be to deprive the statute of any degree of vitality, purpose or meaning since it could be reasonably assumed that the State would always argue that it "believed" its taxing scheme to be legal.

Since O.C.G.A. § 3-4-60, the statute which compelled the payment of the taxes in question, was in fact unconstitutional during 1982, 1983 and 1984, the State of Georgia, in the words of O.C.G.A. § 48-2-35(a), "erroneously or illegally assessed and collected" those taxes from Beam. The executive branch of the government of the State, therefore, under the Due Process Clause and Georgia's refund statute, is obligated—indeed, unequivocally ordered by the Georgia Legislature—to refund "any and all taxes" that Beam paid in 1982, 1983 and 1984. If Beam does not receive a full refund pursuant to this statute in this situation, O.C.G.A. § 48-2-35 can have no purpose, the will of the Legislature will have been thwarted and Beam will have been deprived of the "clear and certain" remedy to which it has a constitutional right. Such a result also usurps this Court's mandates in *Beam* and *McKesson* which usurpation cannot find sanction anywhere. The states of both Florida and Georgia continue to delay payment of any refund where in each instance, the amount in question can be readily determined. By their con-

tinued delay, they undermine the very threshold notion upon which the Supreme Court's decision in *Beam* is premised: "courts are understood only to find the law, not to make it." *Beam*, 111 S.Ct. at 2443.

A review of the history and current status of the *Beam* proceedings upon remand is illustrative of what will befall the Petitioners in the matter at bar unless this Court, in deciding in Petitioner's favor, also clarifies its holding in *McKesson* and *Beam* by finding that the remedy to be afforded the Petitioners is, in fact, that of a refund; that the only issue to be decided upon remand where the amount is not known, is the actual amount paid by the Petitioner under the illegal taxing scheme; and where the amount is known, for judgment to be entered thereupon.

Since the Court's remand of *Beam* to the Georgia Supreme Court, the matter has been further remanded to the Fulton Superior Court. The State persists in asserting in the court below so-called "remedial" issues that it claims are left to be decided. In truth, however, the only remaining task of the court is to enter judgment for Beam in the amount of the illegally collected tax just as surely as the trial court would have done in the initial refund action had it not been mistaken on the retroactivity issue. The State's so-called new allegations and purported defenses which it argues are in conformity with issues this Court left unanswered in *Beam*, point out the need for the Court's intervention; for in realty, the State's defense to a refund is, at bottom, frivolous and not warranted by law.

Georgia has now alleged that the relief sought by Beam is barred due to so-called "reliance interests" of the State and based upon principles of equity and justice. The State of Georgia has asserted that it did not erroneously or illegally assess or collect the taxes in the first instance and that the refund

sought is barred because the rule of law was not clearly foreseen by the State. As a result, the State alleges that a refund would produce substantial hardships upon the State.

It must be remembered that this Court held in *American Trucking* that "[o]nce a constitutional decision applies and renders a tax invalid, due process, not equitable considerations, will generally dictate the scope of relief offered."[6] *American Trucking*, 496 U.S. at 194. From a practical standpoint, Georgia's conduct can be seen as little more than an attempt to delay its duty to provide a *McKesson*-type remedy, all at the extreme expense of Beam and the taxpayers of the State. The huge cost to Beam does nothing other than exacerbate the discrimination it suffered under Georgia's illegal taxing statute since the favored taxpayers are not faced with the delay and costs associated with seeking a refund. Notwithstanding the fact that Beam prevailed in its constitutional challenge to O.C.G.A. § 48-2-35, the State of Georgia is making Beam fight that battle again. This Court in *Beam* and *McKesson* could not have intended such a result.

As can be seen, a determination in favor of Petitioners herein and a remand for purposes of a remedy must also include a clear direction by this Court to the effect that in those cases where a state statutory remedy is in place, like Georgia's refund statute, the minimum remedy to be afforded in the face of the imposition of an illegal tax is compliance with said statute. In the case of Beam and Petitioners herein, a refund of the amount of the illegal tax paid, including that paid during any retroactive period to which the substantive holding of illegality is applied, is mandated. Otherwise, the state of Virginia, as well as Florida, Georgia,

[6]The Georgia refund statute does contain a three-year statute of limitations so as to minimize the burden upon the State in the face of a tax which is found to be illegal.

and of course others, thwart this Court's holdings and deny the class of aggrieved taxpayers the single most effective remedy which comports with due process *i.e.*, a refund.

CONCLUSION

For the reasons stated, this Court should reverse the holding of the Virginia Supreme Court that *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989) be given purely prospective application thereby denying Petitioners refunds of unconstitutional state taxes. Further, this Court should direct that once the question of choice of law is answered in favor of pure retroactivity, states must not undermine that rule by (i) denying aggrieved taxpayers any relief; (ii) by fashioning a remedy which in application is purely prospective; or (iii) by fashioning a remedy in derogation of any applicable state statutory remedy.

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QUESTION PRESENTED

Whether this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), may under any circumstance be "applied" nonretroactively so as to defeat federal retirees' entitlement to refunds of unconstitutional state taxes imposed upon their federal annuities.

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No. 91-794

IN THE SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1992

HENRY HARPER, *ET AL.*,

Petitioners,

vs.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

**On Writ of Certiorari to the
Supreme Court of Virginia**

BRIEF *AMICI CURIAE* FOR DESIGNATED FEDERAL RETIREES IN KANSAS, ARKANSAS, NORTH CAROLINA, MONTANA, SOUTH CAROLINA, NEW YORK, UTAH, ALABAMA AND ARIZONA IN SUPPORT OF PETITIONERS

INTEREST OF THE *AMICI CURIAE*

Amici are the petitioners in *Barker v. Kansas*, 112 S.Ct. 1619 (1992); the respondents in *Pledger v. Bosnick*, 811 S.W.2d 286 (Ark. 1991), *pet. for cert. pending*, No. 91-375; the petitioners in *Swanson v. State*, 407 S.E.2d 791 (N.C.), *adhered to on reh'g*, 410 S.E.2d 490 (N.C. 1991), *pet. for cert. pending*, No. 91-1436; the petitioners in *Sheehy v. Montana*, 820 P.2d 1257 (Mont. 1991), *pet. for cert. pending*, No. 91-1473; the petitioners in *Bass v. South Carolina*, 414 S.E.2d 110 (S.C. 1991), *pet. for cert. pending*, No. 91-1697; the appellants in *Duffy v. Wetzler*, 555 N.Y.S.2d 543

(N.Y. Sup. Ct. 1990), *aff'd as modified*, 579 N.Y.S.2d (N.Y. App. Div. 1992), *appeal dism'd*, (N.Y., Order, July 7, 1992); the cross-appellants in *Brumley v. Utah State Tax Commission*, No. 91-0242 (Utah, argued Apr. 7, 1992); the cross-appellees in *Sizemore v. Rinehart*, No. 2900290 (Ala. App. 1992), *pet. for cert. pending*, (Ala., No. 1911015); and the appellants in *Bohn v. Waddell*, 790 P.2d 772 (Ariz. T.C. 1990), *aff'd on reconsideration*, 807 P.2d 1 (Ariz. T.C. 1991), *appeal pending* No. 1 CA-TX 90-029 (Ariz. App., argued Feb. 12, 1991).[1]

Amici are retired federal employees (civilian and military) involved in litigation which squarely addresses the question presented here: whether this Court's decision in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), may under any circumstances be given nonretroactive effect to defeat the entitlement of federal retirees to a refund of unconstitutional State taxes imposed on their federal retirement benefits. The ultimate disposition of this issue will have a decided impact on the constitutional rights of *amici* and literally hundreds of thousands of retired federal employees in those States which have refused to enforce the clear mandates of 4 U.S.C. § 111, *James B. Beam Distilling Co. v. Georgia*, 111 S.Ct. 2439 (1991), and *McKesson Corp. v. Div. of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238 (1990). Therefore, *amici* have a salient and compelling interest in proper resolution of the question presented in this case.

CONSTITUTIONAL AND STATUTORY PROVISIONS INVOLVED

1. The text of the Supremacy Clause, U.S. Const., art. VI, cl. 2, is set forth in Appendix B, *infra*.

2. The pertinent text of 4 U.S.C. § 111 is set forth in Appendix C, *infra*.

[1]Set forth in Appendix A is a complete list of all *amici*. The written consents of the parties to the filing of this brief *amici curiae* have been filed with the Clerk of the Court.

SUMMARY OF THE ARGUMENT

The refusal of the Virginia Supreme Court to enforce the plain meaning and effect of 4 U.S.C. § 111, despite its application by this Court to the parties in *Davis v. Michigan Dept. of Treasury*, 489 U.S. 803 (1989), directly conflicts with *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991). Furthermore, by suspending the operation of Section 111's prohibition against discrimination until the announcement of *Davis*, its decision offends rudimentary principles of federal supremacy and disregards the solemn judicial obligation to effectuate the clear intent of Congress expressed in an unambiguous statute. The judgment below must be reversed.

In *Davis*, this Court applied 4 U.S.C. § 111 to invalidate a Michigan income tax scheme which favored retired state and local government employees over retired federal employees. 489 U.S. at 817. Enroute to its decision, the Court significantly observed that the "plain" and "unambiguous" terms of 4 U.S.C. § 111 "leave no room for doubt" that the statute protects federal retirees from discriminatory state taxation. 489 U.S. at 808-810 and n.3. In disposing of *Davis*, this Court did not reserve the question of retroactivity; rather, it independently determined that Paul Davis was entitled to a refund of taxes paid in prior years pursuant to Michigan's discriminatory tax scheme. *Id.* at 817.

In *Beam*, every Member of the Court agreed that where the issue of retroactivity is not specifically reserved for subsequent disposition, the rule of law announced in the decision applies to the parties before the Court. *See* 111 S. Ct. at 2451 (O'Connor, J., dissenting opinion, joined by Rehnquist, C.J., and Kennedy, J.). A clear majority of the Court also agreed that when a decision has been retroactively applied to the parties in suit, the decision must be applied retroactively to all other similarly situated litigants. Since *Davis* did not reserve the retroactivity question and clearly applied its decision retroactively to the parties, *Beam* compels that *Davis* must be retroactively applied to all other litigants not barred by procedural limitations or *res judicata*. See *Beam*, 111 S.Ct. at 2448.

Michigan's remedial concession in *Davis* does not affect this conclusion; thus, the opinion below misinterpreted the effect of *Davis* in concluding otherwise.

Although *Beam* alone compels reversal, the Virginia Supreme Court also erroneously applied the analysis described in *Chevron Oil, Inc. v. Huson*, 404 U.S. 97 (1971), to erect a false veneer for its holding that *Davis* was not retroactive. When a judicial decision "d[oes] not overrule clear past precedent nor decide a wholly new issue of impression," it does not satisfy *Chevron's* threshold requirement for nonretroactivity and applies retroactively. *Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202, 3205 (1990) (*per curiam*). Moreover, when a decision like *Davis* has applied settled precedents to construe an unambiguous federal statute in the manner intended by Congress, the rule applies retroactively because it has not altered the law in any material way. *See Hanover Shoe, Inc. v. United States*, 392 U.S. 481, 496-499 (1968). Indeed, *Davis* did not create a new principle of law. To the contrary, *Davis* merely enforced as written the "plain" and "unambiguous" terms of 4 U.S.C. § 111 which "unmistakabl[y]" prohibits discriminatory state taxation of federal retirees. 489 U.S. at 808-810 and n.10. As a decision which straightforwardly applied an unambiguous federal statute, *Davis* merely held that Section 111's express requirements must be enforced as directed by Congress.

The failure to apply *Davis* retroactively would eviscerate the core principles of federal supremacy and separation of powers upon which our constitutional framework is based. Where the language of a congressional enactment is plain, courts have no power to revise a federal statute in accordance with their own notions of considered public policy; instead, courts are required to enforce federal statutes as written. Section 111's unambiguous prohibition against discriminatory state taxation has been the supreme "Law of the Land" since its enactment in 1939 and, by its own force through the Supremacy Clause, has withdrawn all power from the States to enact conflicting legislation. Since an unambiguous Act of Congress must be applied uniformly from its effective date, the Virginia

Supreme Court was not at liberty to defy a clear congressional directive by suspending the national will for over 50 years. Nonretroactive application of *Davis* would suspend Section 111's nondiscrimination clause and would turn federal supremacy on its head, allowing invalid state laws to reign supreme in defiance of the "supreme Law of the Land." The second prong of *Chevron* mandates the retroactivity of *Davis* in order to preserve federal supremacy and to effectuate congressional intent.

Finally, any alleged hardship or inequity which may result from enforcing the unambiguous commands of Congress cannot justify nonretroactive application of *Davis*. The responsibility for the justice and wisdom of legislation rests solely with Congress, while the province of the courts is to enforce, and not make, the laws. In this case, the federal choice of law is, and always has been, the unambiguous terms of 4 U.S.C. § 111. Having exerted judicial power that does not exist to override an unambiguous Act of Congress, the judgment of the Supreme Court of Virginia must be reversed.

ARGUMENT

I. THE OPINION BELOW IRRECONCILABLY CONFLICTS WITH THE DECISION IN *JAMES B. BEAM DISTILLING CO. V. GEORGIA*, 111 S.CT. 2439 (1991)

The controlling rule of decision articulated in *Beam* is that a court commits reversible error whenever it "refuse[s] to apply a rule of federal law retroactively after the case announcing the rule has already done so." 111 S.Ct. at 2446 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.). Despite differences in jurisprudential reasoning between Members of the *Beam* majority, this Court reversed a Georgia Supreme Court judgment which utilized a *Chevron* analysis to conclude that *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), did not apply

to tax refund claims arising before the date of that decision.[2] Accordingly, "when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." *Beam*, 111 S.Ct. at 2448 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.).

In this case, the Virginia Supreme Court concluded on remand that *Beam* does not mandate retroactive application of the decision in *Davis*. Stating that *Davis* did not consider the issue nor rule that its holding applied retroactively to the parties, the opinion below perceived no precedential impediment to the use of *Chevron* analysis in determining whether *Davis* is retroactive. (Pet. 4a). The Virginia court reiterated adherence to its view of the analysis described in *Chevron* and reaffirmed its original decision. (Pet. 4a-5a). Because the lower court's analysis significantly misapprehends the central importance of *Beam* in resolving the proper application of *Davis* and similar decisions of this Court, the judgment below must be reversed.

Without doubt, the majority opinion in *Davis* neither mentioned "retroactivity" nor expressly addressed it as a separate issue for decision. *See* 489 U.S. at 803-817. Judicial silence of this ilk, however, does not support the Virginia court's naked assertion that retroactive application of *Davis* is an unsettled question which may be decided afresh in pending state court litigation. To the contrary, since "retroactivity * * * goes without the saying" in most

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[2]Three members of the Court reached this conclusion as a federal choice of law matter (*see Beam*, 111 S.Ct. at 2446-2448 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.); *and id.* at 2448-2449 (White, J., concurring in judgment)), while three members of the Court concurred in the reversal on broader grounds involving basic norms of constitutional adjudication and limitations on the judicial power (*see id.* at 2449-2450 (Blackmun, J., concurring in judgment, joined by Marshall and Scalia, J.J.); *and id.* at 2450-2451 (Scalia, J., concurring in judgment, joined by Marshall and Blackmun, J.J.)). While the decision in *Beam* was delivered without a majority opinion, it is beyond peradventure that the holding expressed in Justice Souter's plurality opinion articulates the minimally acceptable rule of law which must be applied by lower courts.

decisions of this Court, silence on the issue signifies that the rule announced in a decision has been retroactively applied to the parties before the Court. *Beam*, 111 S.Ct. at 2445 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.). As Justice O'Connor cogently explained:

> **Given that the usual course in cases before this Court is to apply the rule announced to the parties in the case, the most reasonable reading of silence is that the Court followed its customary practice.**

Id. at 2451 (dissenting opinion, joined by Rehnquist, C.J., and Kennedy, J.) (emphasis added). Therefore, when a decision of this Court does not "reserve the question whether its holding should be applied to the parties before it, [the decision] is properly understood to have followed the normal rule of retroactive application in civil cases." *Id.* at 2445 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.) (citation omitted).[3]

Because "[t]he *Bacchus* opinion is silent on the retroactivity question," there was no disagreement among Members of this Court that "*Bacchus* applied its rule retroactively to the parties before it."

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[3]For example, in *Lampf, Pleva, Lipkind, Prupis & Petigrow v. Gilbertson*, 111 S.Ct. 2773 (1991), this Court established a uniform period of limitations for all 10b-5 actions under the Securities and Exchange Act of 1934. Although *Lampf* announced a new rule and overturned established circuit court precedent, that decision was retroactively applied to the parties in suit without any discussion of the retroactivity question. *See Id.* at 2787-2788 (O'Connor, J., dissenting opinion, joined by Kennedy, J.).

On the other hand, when this Court chooses to reserve judgment on the retroactive or prospective application of a rule-changing decision, it has had no difficulty expressing that determination in the rule changing-decision itself. *See, e.g., American Trucking Ass'ns., Inc. v. Scheiner*, 483 U.S. 266, 297-298 (1987) (after deciding the constitutional question presented, the Court remanded the case to Pennsylvania state court "to consider whether our ruling should be applied retroactively"); *Simpson v. Union Oil Co.*, 377 U.S. 13, 24-25 (1964)("We reserve the question whether, when all the facts are known, there may be any equities that would warrant only prospective application in damage suits of the rule governing price fixing by the 'consignment' device which we announce today.").

Beam, 111 S.Ct. at 2451 (O'Connor, J., dissenting opinion, joined by Rehnquist, C.J., and Kennedy, J.). While the Virginia Supreme Court acknowledged that "*Bacchus* applied its rule retroactively to the litigants in that case," the opinion below attempts to avoid the effect of *Beam* on the basis that "the Court made no such ruling in *Davis*." (Pet. 4a). Since *Bacchus* and *Davis* are both silent on the retroactivity question, the Virginia Supreme Court improperly equated the absence of an express ruling on this issue in *Davis* with parochial freedom to independently determine whether the decision should be given retroactive effect.

In *Bacchus*, this Court did not expressly state that its holding would apply retroactively to the taxpayers or the State of Hawaii, and it did not reserve judgment on the issue. *See Bacchus*, 468 U.S. at 276-277. Instead, the case was reversed and remanded to state court solely for consideration of Hawaii's asserted "pass-through defense" to the taxpayers' refund claims. *Beam*, 111 S.Ct. at 2445 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.); *see also Bacchus*, 468 U.S. at 276-277. By logical and necessary implication, such judicial action retroactively applied the holding in *Bacchus* to the parties before the Court without any express consideration or determination of the retroactivity question. *Beam*, 111 S.Ct. at 2445-2446 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.); *id.* at 2448 (White, J., concurring in judgment); *id.* at 2451 (O'Connor, J., dissenting opinion, joined by Rehnquist, C.J., and Kennedy, J.). Therefore, unless the issue has been specifically reserved by this Court for subsequent disposition, the absence of an express ruling on the retroactivity question does not mean that the application of a civil decision is unsettled; instead, it means that the decision will be retroactively applied to the parties in accordance with customary practice.[4]

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[4]For example, in *Barker v. Kansas*, 112 S.Ct. 1619 (1992), this Court applied the plain language of 4 U.S.C. § 111 to invalidate a discriminatory Kansas income tax which favored state and local government retirees over federal military retirees. *Id.* at 1621-1622, 1626. Although the *Barker* decision was announced with a keen awareness of the retroactivity issue (*see* Tr. Oral Argument at 8-10, 38-41, *Barker*

Like the taxpayers in *Bacchus*, Paul Davis challenged the validity of a discriminatory state tax on constitutional grounds, and simultaneously requested retroactive and prospective relief from unlawful taxation. *Davis*, 489 U.S. at 806-807, 817. Mr. Davis also prevailed on the merits of his challenge. *Id.* at 817. However, this Court expressly decided in *Davis* that "to the extent appellant has paid taxes pursuant to this invalid scheme, he is entitled to a refund. *See Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239, 247 (1931)." 489 U.S. at 817. Since *Davis* unequivocally approved the taxpayer's entitlement to a refund of state taxes paid in prior years, its ruling was retroactively applied to the parties before it with even greater clarity than the *Bacchus* decision, which by contrast, "did not grant outright" the taxpayers' request for a refund. *Beam*, 111 S.Ct. at 2445 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.).[5]

The opinion below erroneously concluded that "the issue of retroactivity was not considered * * * in *Davis* because Michigan previously had agreed to the payment of a refund * * * if its taxing scheme were invalidated." (Pet. 4a). The Virginia Supreme Court ignored the fact that Michigan agreed to pay a refund as the appropriate choice of remedy, but only upon the express condition that this Court invalidated the Michigan tax.[6] The Court in *Davis*

(No. 91-611), and nine States urged the Court to specifically reserve this question to avoid its retroactive effect (Brief of Arizona, Arkansas, Georgia, Iowa, Montana, Oklahoma, Utah, Virginia and Wisconsin as *Amicus Curiae* in Support of Respondents at 1-4, *Barker* (No. 91-611)), like *Bacchus* and *Davis*, the *Barker* opinion is silent regarding the scope of its application. Therefore, the *Barker* decision is properly understood to follow the general rule and it has been retroactively applied to the parties before the Court.

[5]On remand from this Court, the Michigan Court of Appeals properly interpreted the *Davis* opinion as "directing that plaintiff receive refund for overpayment of taxes resulting from this disparate treatment." *Davis v. Department of Treasury*, 446 N.W.2d 531 (Mich. App. 1991).

[6]In *Davis*, Michigan relied upon *Iowa-Des Moines National Bank v. Bennett*, 284 U.S. 239 (1931), to argue that *if* the Court invalidated Michigan's discriminatory tax scheme, the inequality could be remedied by either striking the

reached and approved Michigan's concession that Mr. Davis should receive a tax refund (489 U.S. at 817), but only after concluding that Michigan's tax scheme was invalid and only after applying its ruling retroactively to the parties. Under federal law, if the effect of *Davis* was not retroactive, the question of remedy would never have been reached and Mr. Davis could not have been awarded a tax refund. *See American Trucking Ass'ns., Inc. v. Smith*, 110 S.Ct. 2323, 2330 (1990) (O'Connor, J., plurality opinion); *United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S.Ct. 2888 (1991). In light of *Beam*, and retroactive application of *Bacchus* without any discussion of the issue, the Virginia court's assertion that the retroactive effect of *Davis* has no precedential value or effect is patently unsupportable.[7]

While judicial silence alone means that a decision has been retroactively applied, Justice Souter also observed that any qualified or unqualified approval of a taxpayer's entitlement to a refund "necessarily implies that the precedential question has been settled

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exemption which favored state retirees or by extending the exemption to federal retirees. Appellees' Brief at 62-63, *Davis* (No. 87-1020). With respect to prospective remedies, Michigan argued that the Court should remand the case and allow the state courts or legislature an opportunity to make this choice between "remedial alternatives." *Id.* at 63. With respect to retroactive remedies, Michigan argued that providing Mr. Davis a tax refund would satisfy the mandate of equal treatment; therefore, the Court should not retroactively strike the exemptions favoring state retirees, which would have imposed a tax on them. *Id.* at 61-63 and 82-83. Michigan's arguments clearly focused only on the choice between "remedial alternatives" and did not even remotely suggest that Michigan's refund concession had any effect upon the Court's independent decision to retroactively apply its holding to the parties before it.

[7]Michigan's concession that a refund was appropriate does not dilute or undermine the binding effect of this Court's determination that Mr. Davis is "entitled to a refund" under *Iowa-Des Moines Bank*. *Davis*, 489 U.S. at 817. "[S]ince the court cannot be controlled by agreement of counsel on a subsidiary question of law," *Swift & Co. v. Hocking Valley Ry. Co.*, 243 U.S. 281, 289 (1917) (Brandeis, J., majority opinion), the *Davis* decision independently determined the taxpayer's entitlement to a refund by approving the validity of Michigan's position. *Cf. Estate of Sanford v. Comm'r of Internal Revenue*, 308 U.S. 39, 51 (1939) ("We are not bound to accept, as controlling, stipulations as to questions of law.").

to the effect that the rule of law will apply to the parties before the Court." *Beam*, 111 S.Ct. at 2445 (plurality opinion announcing the judgment, joined by Stevens, J.). Because the refund issue was resolved by this Court in *Davis*, that case was remanded to state court solely for payment of the taxpayer's refund and consideration of appropriate prospective relief "to comply with the mandate of equal treatment." *Davis*, 489 U.S. at 816-817. These circumstances convincingly demonstrate that the decision "should be read as having retroactively applied the rule there decided." *Beam*, 111 S.Ct. at 2445-2446 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.)(citing *Davis* as comparative support for this proposition in the retroactive application of *Bacchus*).

Since the taxpayer clearly received the benefit of this Court's decision in *Davis*, the opinion below is nothing less than a transparent attempt to exhume and resuscitate the corpse of selective prospectivity despite its burial in *Beam* and its binding effect on state courts.[8] However, it is now settled that "[o]nce retroactive application is chosen for any assertedly new rule, it is chosen for all others who might seek its prospective application." *Beam*, 111 S.Ct. at 2447-2448 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.). Because the Commonwealth of Virginia is no exception, the judgment below must be reversed.

II. THE OPINION BELOW ERRED BY RELYING ON *CHEVRON* ANALYSIS TO SUSPEND THE NONDISCRIMINATION CLAUSE OF 4 U.S.C. § 111 FOR A PERIOD OF FIFTY YEARS

In *Davis*, this Court applied the nondiscrimination clause of 4 U.S.C. § 111 to invalidate a Michigan income tax scheme which

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[8]In the interest of national uniformity and "to prevent States from denying or curtailing federally protected rights, we have consistently required that state courts adhere to our retroactivity decisions." *American Trucking Ass'ns., Inc. v. Smith*, 110 S.Ct. at 2330 (O'Connor, J., plurality opinion announcing the judgment, joined by Rehnquist, C.J., and White and Kennedy, J.J.).

favored "retired state and local government employees over retired federal employees." 489 U.S. at 817. *See also Barker*, 112 S.Ct. at 1622 ("*Davis* * * * * invalidated under § 111 the Michigan income tax on federal civil service retirees"). That decision also approved Mr. Davis' entitlement to a refund of taxes paid in prior years. *See Davis* 489 U.S. at 817-818. This Court reversed and remanded the case for payment of Mr. Davis' tax refund and prospective compliance "with the mandate of equal treatment." *Id.*

Despite the rejection of selective prospectivity in ***Beam***, the Virginia Supreme Court reaffirmed its adherence to a three-step *Chevron* analysis in determining that "the *Davis* decision is not to be applied retroactively." (Pet. 17a). While straightforward application of *Beam* alone warrants reversal of the judgment below, the Virginia Supreme Court further erred by utilizing *Chevron* analysis to effectively suspend the nondiscrimination clause of 4 U.S.C. § 111 from its enactment in 1939 until the announcement of *Davis* fifty years later. Because Section 111 is an "unambiguous statute" which clearly expresses the intent of Congress in "plain language" with "unmistakable" meaning (*see Davis*, 489 U.S. at 808-810 and n.3), the opinion below improperly refused to enforce its prohibition against discrimination any time before March 28, 1989.

A. The Application of 4 U.S.C. § 111 in *Davis* Did Not Establish a New Principle of Law

Before any judicial decision may be even considered for nonretroactive application, it "'must establish a new principle of law by overruling clear past precedent * * * * or by deciding an issue of first impression whose resolution was not clearly foreshadowed.'" *American Trucking Ass'ns., Inc. v. Smith*, 110 S.Ct. at 2331 (O'Connor, J., plurality opinion) (quoting *Chevron*, 404 U.S. at 106). However, when a decision "d[oes] not overrule clear past precedent nor decide a wholly new issue of first impression," it does not satisfy this threshold requirement and "thus applies retroactively." *Ashland Oil*, 110 S.Ct. at 3205.

The *Davis* decision did not overrule any clear past precedent in invalidating Michigan's income tax on federal retirees. *See* 489 U.S. at 803-818. To the contrary, *Davis* struck down the discriminatory tax by merely enforcing the plain terms of 4 U.S.C. § 111. *Id.* at 812-814, 817; *see also Barker*, 112 S.Ct. at 1622. Without even passing reference to Section 111, however, the opinion below concluded that *Davis* "established a new rule of law by deciding an issue of first impression whose resolution was not clearly foreshadowed." (Pet. 12a). Since *Davis* was decided by applying the "plain" and "unambiguous" language of Section 111 (*see* 489 U.S. at 808-810; *Barker*, 112 S.Ct. at 1622), the Virginia Supreme Court clearly misapprehended the statutory basis for that decision and the necessity of retroactive application.

Generally speaking, "when a decision of this Court merely has applied settled precedents to new and different factual situations," the rule applies retroactively because it has not altered the law "in any material way." *United States v. Johnson*, 457 U.S. 537, 549 (1982). In such cases, "retroactivity * * * goes without the saying." *Beam*, 111 S.Ct. at 2445 (Souter, J., plurality opinion announcing the judgment, joined by Stevens, J.). Similarly, a constitutional decision which merely extends a legal doctrine without overturning established precedent or announcing a "revolutionary" rule "does not meet the first prong of the *Chevron Oil* test." *Ashland Oil*, 110 S.Ct. at 3205.[9] The same is true with respect to decisions which interpret and apply federal statutes. As Justice White explained for the majority in *Hanover Shoe, Inc. v. United Shoe Machinery Corp.*, 392 U.S. 481 (1968), a decision which applies a federal statute based on "existing authorities" without "adopting a radically new interpretation" will be given

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[9] In *Ashland Oil*, a unanimous Court held that *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), applied retroactively in determining the constitutionality of a West Virginia gross receipts tax for the fiscal years ending September 1975 and 1976. 110 S.Ct. at 3203-3205. While *Armco* contributed to the development of dormant Commerce Clause jurisprudence by adopting the internal consistency test, the decision did not satisfy the threshold requirement for nonretroactive application because it neither overruled established precedent nor decided a wholly new issue of first impression. *Id.* at 3205.

retroactive effect unless it marks "such an abrupt and fundamental shift in doctrine as to constitute an entirely new rule which in effect replaced an older one." *Id.* at 497-498.[10]

Because "Acts of Congress are generally to be applied uniformly throughout the country from the date of their effectiveness onward," only the most exceptional circumstances can ever "warrant withholding retroactive application of a decision construing a statute as Congress intended it." *United States v. Estate of Donnelly*, 397 U.S. 286, 294-295 (1970). In rare instances, this Court has reserved judgment on the issue when overruling its own construction of a statute (*see Simpson v. Union Oil Co.*, 377 U.S.

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[10]In *Hanover Shoe*, this Court held that *American Tobacco Co. v. United States*, 328 U.S. 781 (1946), would be retroactively applied in determining a plaintiff's entitlement to damages under the Sherman Act. The Court of Appeals had concluded that *American Tobacco* would not be given retroactive effect and that Hanover could not recover damages prior to its announcement on June 10, 1946 reasoning that *American Tobacco* "fundamentally altered the law of monopolization" by eliminating proof of predatory practices in addition to monopoly power. *Hanover Shoe*, 392 U.S. at 495. This Court reversed, reasoning in relevant part:

> In the *American Tobacco* case, this Court noted that the precise question before it had not been previously decided * * * and gave no indication that it thought it was adopting a radically new interpretation of the Sherman Act. Like the Court of Appeals [in *United States v. Aluminum Co. of America*, 148 F.2d 416 (2d Cir. (1945)], this Court relied for its conclusion upon existing authorities. These cases make it clear that there was no accepted interpretation of the Sherman Act which conditioned a finding of monopolization under § 2 upon a showing of predatory practices by the monopolist. In neither case was there such an abrupt and fundamental shift in doctrine as to constitute an entirely new rule which in effect replaced an older one. Whatever development in antitrust law was brought about was based to a great extent on existing authorities and was an extension of doctrines which had been growing and developing over the years. These cases did not constitute a sharp break in the line of earlier authority or an avulsive change which caused the current of the law thereafter to flow between new banks.

Hanover Shoe, 392 U.S. at 496-499 (White, J., majority opinion) (citation omitted).

at 24-25), or denied retroactive effect to a decision which resolved complex questions of first impression involving the application of an ambiguous statute in light of conflicting legislative history (see *Allen v. State Board of Elections*, 393 U.S. 544, 570-571 (1969)). However, no exceptional circumstances are present here that can justify suspending application of the plain language of the nondiscrimination clause of 4 U.S.C. § 111 until the announcement of *Davis* on March 28, 1989.[11]

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[11]In *Arizona Governing Committee v. Norris*, 463 U.S. 1073 (1983) and *Los Angeles Dept. of Water & Power v. Manhart*, 435 U.S. 702 (1978), this Court held that Title VII prohibited employers from requiring women to make larger contributions in order to obtain the same deferred compensation and pension plan benefits as men. Neither case was given retroactive effect.

Recognizing that Title VII was not "intended to revolutionize the insurance and pension industries" and the statute "does not require * * * any retroactive relief," the Court in *Manhart* concluded that changes in the legal rules governing pension and insurance funds "should not be applied retroactively unless the legislature has plainly commanded that result." 435 U.S. at 717-718, 721. However, the Congress and EEOC have recognized the "importance of making only gradual and prospective changes in the rules that govern pension plans." *Id.* at 721-722 and n.40. Given the potentially devastating effect of retroactive liability on the insurance industry and pension plans, where the harm would be largely felt by innocent third parties, it would be inequitable to impose such relief based on the "unforeseen" contingency of a Title VII decision "which represents a marked departure from past practice." *Manhart*, 435 U.S. at 721-723.

In *Norris*, five Members of this Court concluded that its decision should be given only prospective effect. Relying upon the intent of Congress expressed in the McCarran-Ferguson Act (15 U.S.C. § 1011 *et seq.*) and Title VII's legislative history, four Members of the Court dissented from the application of *Manhart* to voluntary deferred compensation plans and reasoned, based on *Manhart* itself, that an award of retroactive relief "would be both unprecedented and manifestly unjust." 463 U.S. at 1099-1105 (Powell, J., dissenting in part and concurring in part, joined by Burger, C. J., and Blackmun and Rehnquist, J.J.). Justice O'Connor provided the pivotal swing vote for nonretroactive application of *Norris*. Reasoning that "the answer" on the merits "is far from self-evident" because "the general language chosen by Congress does not clearly resolve the precise question," Justice O'Connor applied *Chevron* analysis and the Court's equitable powers under Title VII to fashion an appropriate prospective remedy. 463 U.S. at 1107-1111 (concurring opinion).

In view of the unique circumstances present in *Manhart* and *Norris*, both decisions are inapposite to proper resolution of this case.

When Congress originally enacted 4 U.S.C. § 111 as part of the Public Salary Tax Act of 1939, ch. 59, § 4, 53 Stat. 575 (effective January 1, 1939), it consented to state taxation of current and retired federal employees "if the taxation does not discriminate against the * * * employee because of the source of the pay or compensation." *See Davis*, 489 U.S. at 808-809. Under settled principles of statutory interpretation, the "plain language" of Section 111 "leaves no room for doubt" that it protects federal retirees from discriminatory state taxation (*Davis*, 489 U.S. at 808-810 and n.3), and "the retention of immunity in § 111 is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity" (*id.* at 813). This principle of nondiscrimination precludes any State from taxing federal retirees if "it treats someone else better than it treats them." *Washington v. United States*, 460 U.S. 536, 545 (1983). Section 111 accordingly prohibits the imposition of state taxes which discriminate against federal retirees in favor of state retirees unless "the inconsistent tax treatment is directly related to, and justified by, 'significant differences between the two classes.'" *Davis*, 489 U.S. at 816 (quoting *Phillips Chemical Co. v. Dumas Independent School Dist.*, 361 U.S. 376, 383 (1960)). *See also Barker*, 112 S.Ct. at 1622.[12]

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[12]Even the lone dissenter in *Davis* conceded that "[a]rguably, the Court's holding today is merely a logical extension of our decisions in *Phillips Chemical* * * *, and *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392 (1983)." 489 U.S. at 824 (Stevens, J., dissenting opinion). In light of these and other precedents which have recognized or applied the nondiscrimination principle, this acknowledgment by Justice Stevens demonstrates that *Davis* did not arrive like a bolt from the blue. *See, e.g., Memphis Bank*, 459 U.S. at 397-399 (applying the nondiscrimination clause of 31 U.S.C. § 742 "as principally a restatement of the constitutional rule" to invalidate a Tennessee bank tax which discriminated "in favor of securities issued by Tennessee and its political subdivisions and against federal obligations * * * * by including in the tax base income from federal obligations while excluding income from otherwise comparable state and local obligations."); *Phillips Chemical*, 361 U.S. at 383-387 (applying the nondiscrimination principle to invalidate a Texas lease tax which impermissibly imposed a greater tax burden on lessees of federal property than lessees of exempt property owned by the State and its political subdivisions). Thus, the most that can be said about *Davis* is that the Court relied upon (and perhaps logically extended) settled judicial precedent in applying the nondiscrimination clause of 4 U.S.C. § 111.

Because Section 111 is an "unambiguous statute" which "leaves no room for doubt" regarding the scope of its intended meaning, application and effect (*see Davis*, 489 U.S. at 809-810, 812-813 and n.3), the duty of the courts "is simply to enforce the law as it is written, unless clearly unconstitutional." *Chung Fook v. White*, 264 U.S. 443, 446 (1924). This solemn obligation of the judiciary to enforce the intent of Congress expressed in unambiguous legislation is beyond dispute. *See United States v. Ron Pair Enterprises, Inc.*, 489 U.S. 235, 241 (1989) ("where, as here, the statute's language is plain, 'the sole function of the court is to enforce it according to its terms.'") (citation omitted).[13]

Writing for the Court in *Norfolk & Western v. American Train Dispatchers*, 111 S.Ct. 1156 (1991), Justice Kennedy recently explained:

> As always, we begin with the language of the statute and ask whether Congress has spoken on the subject before us. **'If the intent of Congress is clear, that is the end of the matter; for the court * * * * must give effect to the unambiguously expressed intent of Congress.'**

Id. at 1163 (quoting *Chevron U.S.A. Inc. v. Natural Resources*

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[13]See also *Texas Cement Co. v. McCord*, 233 U.S. 157, 163 (1914) (unanimous opinion) ("it is only the province of the courts to enforce the statute in accordance with its terms."); *St. Louis & Iron Mountain Railway Co. v. Taylor*, 210 U.S. 281, 295 (1908) (the courts "have * * * no duty except to enforce the law as it is written"); *Bate Refrigerating Co. v. Sulzberger*, 157 U.S. 1, 37-38 (1895) ("where the meaning of the legislature was plain 'it must be obeyed.'")(quoting *United States v. Fisher*, 6 U.S. (2 Cranch) 358, 385 (1805)); *Thornley v. United States*, 113 U.S. 310, 313 (1885) ("Where the meaning of a statute is plain, it is the duty of the courts to enforce it according to its obvious terms."); *The Cherokee Tobacco*, 78 U.S. (11 Wall.) 616, 620 (1870) (where the language of a federal statute is clear and unambiguous, "[i]t is the duty of the courts to execute it."); *United States v. Rogers*, 45 U.S. (4 How.) 567, 572 (1846) ("It is our duty to expound and execute the law as we find it.").

Defense Council, Inc., 467 U.S. 837, 842-843 (1984) (emphasis added)). *See also Patterson v. Shumate*, 60 U.S.L.W. 4550, 4551 (U.S., June 15, 1992) (No. 91-913) (Blackmun, J., unanimous opinion) (in applying "the plain language" of 11 U.S.C. § 541(c)(2), the Court "must enforce the statute according to its terms."). Therefore, **"when a federal statute unambiguously forbids the States to impose a particular kind of tax * * *, courts need not look beyond the plain language of the federal statute to determine whether a state statute that imposes such a tax is pre-empted."** *Aloha Airlines, Inc. v. Director of Taxation*, 464 U.S. 7, 12 (1983) (unanimous opinion) (emphasis added) (invalidating a Hawaii tax on airline gross receipts which violated "the plain meaning" of 49 U.S.C. § 1513(a)).[14]

Since the intent of Congress is clearly expressed in the unambiguous language of 4 U.S.C. § 111, application of this longstanding statutory mandate in *Davis* did not create any "new" principle of federal law; rather, it fulfilled this Court's duty to enforce valid congressional legislation which is and has been the "supreme Law of the Land." *See* U.S. Const. art. VI, cl. 2. While the nondiscrimination clause of Section 111 is binding on "the Judges in every State" (U.S. Const., art. VI, cl. 2), the Virginia Supreme Court has persistently refused to enforce it. *Contra McCullough v. Maryland*, 17 U.S. (4 Wheat.) 316, 426 (1819) (Marshall, C.J., unanimous opinion) ("This great principle is, that the constitution and the laws made in pursuance thereof are supreme; that they control the constitution and laws of the respective States, and cannot be controlled by them."). Both opinions of the Virginia court have indefensibly ignored federal supremacy under the rubric of *Chevron* by suspending enforcement

[14] "When we find the terms of a statute unambiguous, judicial inquiry is complete except in rare and exceptional circumstances." *Demarest v. Manspeaker*, 111 S.Ct. 599, 604 (1991) (Rehnquist, C.J., unanimous opinion). These rare and exceptional cases, however, exist only where "the literal application of a statute will produce a result demonstrably at odds with the intentions of its drafters." *Griffin v. Oceanic Contractors, Inc.*, 458 U.S. 564, 571 (1982); *accord Demarest*, 111 S.Ct. at 604. Given the clarity of 4 U.S.C. § 111, however, this exception has no application here.

of the nondiscrimination clause of Section 111 in Virginia any time before 1989. *Contra McCullough*, 17 U.S. (4 Wheat.) at 436 ("the States have no power * * * to retard, impede, burden, or in any manner control, the operations of the constitutional laws enacted by Congress * * * * This is, we think, the unavoidable consequence of that supremacy which the constitution has declared."). Regardless of the bounds or propriety of "pure" prospectivity, however, this doctrine cannot ever be applied to any judicial decision which enforces the plain language and intent of an unambiguous federal statute unless a court is willing to disregard the Supremacy Clause, the intent of Congress and the limitations on judicial power applicable in cases arising under the laws of the United States.

Under our constitutional system of government, the supreme lawmaking power is vested in Congress as the national legislature. *See* U.S. Const., art. I, § 1; *Youngstown Sheet and Tube Co. v. Sawyer*, 343 U.S. 579, 587-588 (1952). *See also The Federalist No. 44*, at 356 (J. Madison) (J. Hamilton ed. 1869); *The Federalist No. 33*, at 255 (A. Hamilton) (J. Hamilton ed. 1869). Because it is undisputed that 4 U.S.C. § 111 is a valid exercise of legislative authority, no court can lawfully refuse to apply the "unmistakable" meaning of its "unambiguous" prohibition against discrimination. *See Rose v. Arkansas State Police*, 479 U.S. 1, 3 (1986) (*per curiam*) ("the Supremacy Clause invalidates all state laws that conflict or interfere with an Act of Congress."). From its effective date in 1939, Section 111 has operated through the Supremacy Clause to withdraw all power from the States to enact conflicting legislation.

In the authoritative words of Chief Justice Marshall, "[i]t is the very essence of supremacy to remove all obstacles to its action within its own sphere, and so to modify every power vested in subordinate governments, as to exempt its own operations from their own influence." *McCullough*, 17 U.S. (4 Wheat.) at 427. Consequently, 4 U.S.C. § 111 has outlawed discriminatory State taxation by its own force without any need for a judicial declaration to that effect.

> Every constitutional act of Congress is passed by the will of the people of the United States, expressed through their representatives, on the subject-matter of the enactment; and when so passed it becomes the supreme law of the land, and operates by its own force on the subject-matter, in whatever state or territory it may happen to be.

Pollard's Lessee v. Hagan, 44 U.S. (3 How.) 212, 224-225 (1845). Since the "plain language" and "unmistakable" meaning of 4 U.S.C. § 111 have been the "supreme Law of the Land" for more than 50 years, *Davis* did not establish a "new" principle of federal law which in effect replaced an older one; instead, this Court simply applied the Supremacy Clause to invalidate a state statute which conflicted with the plain meaning of an unambiguous federal statute.

The Virginia Supreme Court's assertion that *Davis* established a "new" principle of law likewise ignores settled limitations on the judicial power which require enforcement of valid congressional enactments. *See Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395, 406 (1967) ("Federal courts are bound to apply rules enacted by Congress with respect to matters * * * over which it has legislative power."); *Stewart Organization, Inc. v. Ricoh Corp.*, 487 U.S. 22, 27 (1988) (same); *Lake County v. Rollins*, 130 U.S. 662, 672-673 (1889) (the judicial function is limited to enforcing the laws as enacted). Under our tripartite system of government and the separation of powers doctrine, "[t]his court * * * * * has no legislative powers." *License Tax Cases*, 72 U.S. (5 Wall.) 462, 469 (1866); *see also Del Monte Mining and Milling Co. v. Last Chance Mining and Milling Co.*, 171 U.S. 55, 66 (1898) ("beyond the terms of the statute courts may not go. They have no power of legislation."); *The Federalist No. 78*, at 576, 579 (A. Hamilton) (J. Hamilton ed. 1869); *The Federalist No. 47*, at 376 (J. Madison) (J. Hamilton ed. 1869). It is equally beyond dispute that courts have no power to revise or veto valid congressional enactments. See *United States v. Rutherford*, 442 U.S. 544, 555 (1979) ("Under our constitutional framework, federal courts do not sit as councils of revision, empowered to rewrite legislation in accord with their own

conceptions of prudent public policy."); *TVA v. Hill*, 437 U.S. 153, 194-195 (1978) ("We do not sit as a committee of review, nor are we vested with the power of veto."); *United States v. Nixon*, 418 U.S. 683, 704 (1974) (the President may not share the veto power with the Judiciary).

In cases or controversies within its jurisdiction (U.S. Const., art. III), "[t]he responsibility of this Court * * * is to construe and enforce the Constitution and laws of the land as they are and not to legislate social policy on the basis of our own personal inclinations." *Evans v. Abney*, 396 U.S. 435, 447 (1970). Because the Court has no legislative powers, "[i]t cannot amend or modify any legislative acts" (*License Tax Cases*, 72 U.S. (5 Wall.) at 469), and it has "no authority to substitute [its] views for those expressed by Congress in a duly enacted statute." *Mobil Oil Corp. v. Higginbotham*, 436 U.S. 618, 626 (1978). *See also New York Nat. Bank v. Massey*, 192 U.S. 138, 146 (1904) ("We are to interpret statutes, not to make them."). Consequently, "[f]or this court to * * * disregard the plain language and the plain intent" of an unambiguous federal statute "would be to enact a new law under the pretense of construing one and thus pronounce itself guilty of a flagrant perversion of the judicial power." *Heiner v. Donnan*, 285 U.S. 312, 331 (1932).

As a statutory case, the central import of *Davis* "is not to make a new law but only to hold that the law always meant what the court now says it means." *Fleming v. Fleming*, 264 U.S. 29, 31-32 (1924) (Taft, C.J., unanimous opinion). Because the nondiscrimination clause of 4 U.S.C. § 111 has operated in all States since 1939, the retroactive application of *Davis* is a constitutional imperative. Inasmuch as Section 111 is an "unambiguous statute" whose "overall meaning * * * is unmistakable" (*Davis*, 489 U.S. at 809-310 and n.3), settled limitations on the judicial power prohibited this Court in *Davis* from nullifying the plain intent of Congress through prospective decisionmaking. Despite the total absence of judicial power to override Section 111, the opinion below has nevertheless suspended the operation of its nondiscrimination clause in Virginia before

March 28, 1989. While "[t]he court has power to construe a legislative act, * * * it has no power by change in construction to date its passage as a law from the time of the later decision." *Fleming*, 264 U.S. at 32; *see also State Tonnage Tax Cases*, 79 U.S. (12 Wall.) 204, 217 (1871) ("Legislative enactments, where the language is unambiguous, cannot be changed by construction").[15]

Given these circumstances, it is unthinkable that *Davis* established a new principle of law on the asserted basis that Virginia could not have known "a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation." (Pet. 12a). Because valid federal statutes "control the constitution and laws of the respective States, and cannot be controlled by them" *(McCullough*, 17 U.S. (4 Wheat.) at 426), the force and effect of 4 U.S.C. § 111 does not turn on the self-serving perceptions of the States. Any such assertion belies federal supremacy as well as the intent of Congress expressed in Section 111 to protect the United States and its retired employees from any discriminatory tax regardless of whether it actually "interfere[s] with the Federal Government's ability to perform its governmental functions." *See Davis*, 489 U.S. at 812-814; *cf. Washington v. United States*, 460 U.S. 536, 546 n. 12 (1983) (Rehnquist, J., majority opinion) ("when Congress has acted in this field, it has applied a nondiscrimination rule" to determine the validity of state taxes). Under Section 111 and the modern tax immunity doctrine, the critical requirement is "that the government tax in a nondiscriminatory fashion." *South Carolina v. Baker*, 485 U.S. 505, 526 n.15 (1988). *See also Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 485-487 (1939); *id.* at 488 (Frankfurter, J., concurring opinion) ("state and federal governments must avoid

[15]Indeed, "a statute 'is not an empty vessel into which this Court is free to pour a vintage that we think better suits present-day tastes.'" *National Broiler Marketing Ass'n v. United States*, 436 U.S. 816, 827 (1978) (quoting *United States v. Sisson*, 399 U.S. 267, 297 (1970)).

exactions which discriminate against each other . . ."). [16]

Nevertheless, as this Court unequivocally observed in *Davis*, preferential tax exemptions for retired state and local government employees "to reduce the State's employment costs at the expense of the federal treasury are the type of discriminatory legislation that the doctrine * * * is intended to bar." 489 U.S. at 815 n.4. Since state tax discrimination against the United States or those with whom its deals invariably causes them to suffer unequal economic burdens (*cf. Washington v. United States*, 460 U.S. at 544), there has never been any departure from the principle that "a state tax may not discriminate against the Government or those with whom it deals." *Phillips Chemical*, 361 U.S. at 387. *See also Davis*, 489 U.S. at 812.

Simply stated, *Davis* did not establish a new principle of law by overruling past precedent or deciding a wholly new issue of first impression; rather, *Davis* applied the plain language and unmistakable meaning of 4 U.S.C. § 111 to enforce the "supreme Law of the Land" as it has existed since 1939. By mischaracterizing the holding in *Davis* as a new principle of law and refusing to give it any retroactive effect, the Virginia Supreme Court unlawfully suspended the nondiscrimination principle of Section 111 for more than 50 years. The opinion below has accordingly overridden an express determination of Congress in violation of the Supremacy Clause by asserting judicial power which does not exist. Because the holding in *Davis* cannot be given nonretroactive effect without offending principles of federalism and federal supremacy through unprecedented judicial usurpation of legislative power, the judgment of the Virginia Supreme Court must be reversed.

[16]"[I]t is the discrimination, not the quality of the burden, that carries unconstitutional consequences." *Washington v. United States*, 460 U.S. at 555 (Blackmun, J., dissenting opinion, joined by White, Marshall and Stevens, JJ.); *cf. Bacchus* , 468 U.S. at 269 ("It is well settled that '[w]e need not know how unequal the Tax is before concluding that it unconstitutionally discriminates.'") (quoting *Maryland v. Louisiana*, 451 U.S. 725, 760 (1981)).

B. Retroactive Application of *Davis* is Necessary to Enforce Federal Supremacy and Limitations on the Judicial Function

Under the plurality's approach in *American Trucking Ass'ns., Inc. v. Smith*, the second factor which must be examined is "'the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.'" 110 S.Ct. at 2331 (O'Connor, J.) (quoting *Chevron*, 404 U.S. at 106-107). Despite its failure to discuss the existence, history, purpose or effect of the nondiscrimination principle applied in *Davis*, the opinion below summarily concluded that "the second prong of the *Chevron* test is satisfied." (Pet. 12a). Although the Virginia General Assembly remedied the "defects in its statute" on a prospective basis following the announcement of *Davis* (*id.*),[17] such limited corrective action does not fully enforce the longstanding prohibition against discrimination, and it does not legitimize or eradicate Virginia's past practice of unlawful taxation.

For more than 50 years, 4 U.S.C. § 111 has fully codified "the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity." *Davis*, 489 U.S. at 813. This nondiscrimination principle arises from the Supremacy Clause (*South Carolina v. Baker*, 485 U.S. at 518 n.11), and "has, from the time of *McCullough v. Maryland*, barred taxes that 'operat[e] so as to discriminate against the Government or those with whom it deals.'" *Davis*, 489 U.S. at 812 (quoting *United States v. City of Detroit*, 355 U.S. 466, 473 (1958)). It is, accordingly, beyond question that a State tax scheme which favor those who deal with the State over those who deal with the Federal Government is unlawful except in the most limited circumstances with no application here. *See Barker*, 112 S.Ct. at

[17] By contrast, certain other States such as Kansas did not voluntarily take any corrective action in response to the *Davis* decision. *See Barker*, 112 S.Ct. at 1622, 1626.

1622; *Davis*, 489 U.S. at 815-817; *Memphis Bank*, 459 U.S. at 397-399.[18]

While the tax immunity doctrine is based on the need to protect federal operations from undue interference by the States, "all precedent" has established a "settled rule" that those who deal with the United States -- including federal retirees -- are entitled to protection from discriminatory taxation. *See Davis*, 489 U.S. at 814-815.[19] It is equally settled that such "a discriminatory tax is void and 'may not be exacted.'" *Moses Lake Homes, Inc. v. Grant County*, 365 U.S. 744, 752 (1961) (quoting *Phillips Chemical*, 361 U.S. at 387). Because the plain language of 4 U.S.C. § 111 has operated by its own force to prohibit State tax discrimination against federal retirees, nonretroactive application of *Davis* would conflict with congressional intent, federal supremacy, limitations on the judicial power and due process of law.[20]

[18] *See also United States v. County of Fresno*, 429 U.S. 452, 462 (1977); *Phillips Chemical*, 361 U.S. at 383-385; *cf. Bacchus*, 468 U.S. at 273 (preferential tax exemptions are discriminatory regardless of motivation); *id.* at 286 (Stevens, J., dissenting opinion, joined by Rehnquist and O'Connor, J.J.) (providing a special benefit in the form of a tax exemption is a kind of discrimination).

[19] As this Court observed in *Davis*, "[t]he danger that a State is engaging in impermissible discrimination against the Federal Government is greatest when the State acts to benefit itself and those in privity with it." 489 U.S. at 815 n.4. To protect the United States from even the possibility of impermissible discrimination, consent to taxation under 4 U.S.C. § 111 has been "expressly confined" to state and local "taxation which does not discriminate against [federal] officers or employees because of the source of their compensation." S.Rep. 112, 76th Cong., 1st Sess. 12 (1939); H.R. Rep. 26, 76th Cong., 1st Sess. 5 (1939).

[20] In a related context, this Court has observed that victims of tax discrimination may not be deprived of their "legal right to recover the amount of the tax unlawfully exacted" through prospective decisionmaking which "leaves the monies thus exacted in the public treasury." *Montana National Bank of Billings v. Yellowstone County*, 276 U.S. 499, 504-505 (1928). *See also McKesson v. Div. of Alcoholic Beverages & Tobacco*, 110 S.Ct. 2238, 2247-2250 (1990). "The very essence of civil liberty certainly consists in the right of every individual to claim the protection of the laws whenever he receives an injury. One of the first duties of government is to afford that protection." *Marbury v. Madison*, 5 U.S. (1 Cranch) 137, 162-163 (1803).

It is true that the tax immunity doctrine is not intended to prevent "legitimate" taxation (Pet. 12a), however, Virginia's discriminatory tax has never been "legitimate." The opinion below misinterpreted and misapplied the analysis of Justice O'Connor in *American Trucking Ass'ns., Inc. v. Smith* to declare that "Virginia's taxing statute was legitimate until" the announcement in *Davis*. *Id.* In *American Trucking Ass'ns., Inc. v. Smith*, the plurality concluded that an Arkansas tax was "legitimate" before the announcement of *American Truck Ass'ns., Inc. v. Scheiner*, 483 U.S. 266 (1987), because "*Scheiner* established a 'new principle of law' by *overruling* those aspects of the *Aero Mayflower* cases on which the State of Arkansas relied in enacting and assessing the * * * tax." 110 S.Ct. at 2332 (emphasis added). By stark contrast, *Davis* did not overrule any established precedent and *amici* are unaware of a single decision of this Court which furnishes any genuine support for Virginia's decision to unlawfully favor state and local government retirees over federal retirees. Indeed, Virginia's discriminatory tax scheme always conflicted with the plain language of 4 U.S.C. § 111; therefore, it cannot attain legitimacy through judicial fiat. Where the State's "power to tax (federal retirees) is not unlimited, validity is not established by the mere imposition of a tax," (*cf. Mullaney v. Anderson*, 342 U.S. 415, 418 (1952) (Frankfurter, J., majority opinion)), nor is it established by the passage of many years without legal challenge (*Ashland Oil*, 110 S.Ct. at 3205 n*). Since Virginia has never had any power to impose discriminatory taxes against retired federal employees, its offensive tax scheme in effect before *Davis* was void *ab initio* and cannot be legitimized after the fact by a stroke of the judicial pen.

"[A] state enactment, even if passed in the exercise of its acknowledged powers, must yield, in case of conflict, to the supremacy of the Constitution of the United States and the acts of Congress enacted in pursuance of its provisions." *Northern Securities Co. v. United States*, 193 U.S. 197, 347 (1904). *See also McCray v. United States*, 195 U.S. 60 (1904). Because the nondiscrimination clause of 4 U.S.C. § 111 has been in operation since 1939 (*see Pollard's Lessee*, 44 U.S. (3 How.) at 224-225),

this statute imposes an absolute requirement which may not be abrogated, compromised or suspended by the States. *See McKesson*, 110 S.Ct. at 2246 ("state courts must interpret and enforce faithfully the 'supreme Law of the Land'"). As this Court explained in *Trinityfarm Co. v. Grosjean*, 291 U.S. 466 (1934), application of the tax immunity doctrine "does not depend upon the amount of the exaction, the weight of the burden or the extent of the resulting interference with sovereign independence. Where it applies, the principle is an absolute one wholly unaffected by matters or distinctions of degree." *Id.* at 471. *See Washington v. United States*, 460 U.S. at 554 (Blackmun, J., dissenting opinion, joined by White, Marshall and Stevens, J.J.) ("The Supremacy Clause does not merely guarantee equality; it absolutely immunizes [those who deal with] the United States from discriminatory state taxation.").

If this Court sanctions Virginia's impermissible judicial legislation to validate discriminatory taxation against federal retirees from January 1, 1939 to March 28, 1989, the statutory nondiscrimination principle will be emasculated and the Supremacy Clause will become an "empty and unmeaning declamation." *McCullough*, 17 U.S. (4 Wheat.) at 433. "It would declare, that if the legislature shall do what is expressly forbidden, such act, notwithstanding the express prohibition, is in reality effectual." *Marbury v. Madison*, 5 U.S. (1 Cranch) at 178. Retroactive application of *Davis* is thus necessary to further established principles of federalism and federal supremacy, without which "the world * * * would [see] a monster, in which the head [is] under the direction of the members." *The Federalist No. 44*, at 356 (J. Madison) (J. Hamilton ed. 1869). If States may invoke the nonretroactivity doctrine to avoid the controlling force of an unambiguous federal statute, "the resolutions or commands which pretend to be laws, will in fact amount to nothing more than advice or recommendation." *The Federalist No. 15*, at 143 (A. Hamilton) (J. Hamilton ed. 1869). The judgment below should accordingly be reversed.

C. Any Alleged Hardship or Inequity Which May Result From Enforcing the Nondiscrimination Clause of 4 U.S.C. § 111 Cannot Justify Nonretroactive Application of *Davis*

Under the plurality's approach in *American Trucking Ass'ns., Inc. v. Smith*, the final factor which must be examined is "'the inequity imposed by retroactive application,'" because in some law-changing decisions, "'injustice or hardship [may be avoided] by a holding of nonretroactivity.'" 110 S.Ct. at 2331 (O'Connor, J.) (quoting *Chevron*, 404 U.S. at 107). Despite its failure to acknowledge the existence, operation or effect of 4 U.S.C. § 111, the opinion below concluded that nonretroactive application of *Davis* was required to avoid potentially disruptive financial consequences for Virginia and its citizens. (Pet. 13a-14a). However, the nondiscrimination clause of Section 111 must be enforced regardless of the consequences; equitable considerations are simply irrelevant to the proper application of an unambiguous federal statute.

Even where the plain meaning of a federal statute, if applied, may result in "disastrous" or "harsh consequences, it cannot influence the courts in administering the law. The responsibility for the justice or wisdom of legislation rests with the Congress and it is the province of the courts to enforce, not to make, the laws." *United States v. First National Bank of Detroit*, 234 U.S. 245, 260 (1914); *accord, St. Louis & Iron Mountain Railway Co. v. Taylor*, 210 U.S. at 295 (the "harshness" of unambiguous legislation "is no concern of the courts").[21] "The Founders of this Nation entrusted the lawmaking power to the Congress alone in both good and bad times. It would do no good to recall the historical events, the fears of power and the hopes for freedom that lay behind their choice."

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[21] *See also Helvering v. New York Trust Co.*, 292 U.S. 455, 464 (1934); *United States v. Missouri Pacific Railroad Co.*, 278 U.S. 269, 277-278 (1929); *Commr. of Immigration of Port of New York v. Gottlieb*, 265 U.S. 310, 313 (1924); *Low Wah Suey v. Backus*, 225 U.S. 460, 476 (1912); *United States v. Fisher*, 6 U.S. (2 Cranch) at 386 (Marshall, C.J.) (if the meaning of a federal statute is plain, "it must be obeyed" even "where great inconvenience will result.").

Youngstown Sheet and Tube, 343 U.S. at 589. Consequently, in cases when the application of an unambiguous federal statute "may result in disruption of state systems of taxation," this Court is "bound by the plain language of the statute." *Aloha Airlines*, 464 U.S. at 14 n.10.

Likewise, "[t]he court cannot add an exception based on equitable grounds when Congress forebore to make such an exception." *Louisville and Nashville Railroad Co. v. Mottley*, 219 U.S. 467, 479 (1911).[22] "To do so, would be to usurp the function of another and a distinct governmental department. It would be legislation, and not adjudication." *Leffingwell v. Warren*, 67 U.S. 599, 605 (1862). As this Court observed in upholding the validity of a state labor statute:

> [I]f it be said that a statute * * * is mischievous in its tendencies, the answer is that the responsibility therefor rests upon legislators, not upon the courts. **No evils arising from such legislation could be more far-reaching than those that might come to our system of government if the judiciary, abandoning the sphere assigned to it by the fundamental law, should enter the domain of legislation, and upon grounds merely of justice or reason or wisdom annul statutes that had received the sanction of the people's representatives.** '

Atkin v. Kansas, 191 U.S. 207, 223 (1903) (emphasis added). Indeed, "[i]t would be better * * * to look hardship in the face rather than break down the rules of law." *St. Louis & Iron Mountain Railway Co. v. Taylor*, 210 U.S. at 295.

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[22] *Accord, Freytag v. C.I.R.*, 111 S.Ct. 2631, 2636 (1991) ("courts 'are not at liberty to create an exception where Congress has declined to do so.'") (quoting *Hallstrom v. Tillamook County*, 110 S.Ct. 304, 309 (1989)); *Corona Co. v. United States*, 263 U.S. 537, 540 (1924) (where "the words of the statute are plain * * * * we are not at liberty to add an exception in order to remove apparent hardship in particular cases.").

In applying its view of the equities under *Chevron* to determine whether *Davis* should be given retroactive effect, the Virginia Supreme Court misperceived its judicial responsibility and usurped the prerogative of Congress by refusing to enforce the plain terms of Section 111. Under our constitutional system of government, equitable considerations do not affect the judicial obligation to apply unambiguous statutes enacted by Congress pursuant to its constitutional powers. Because no court is empowered to suspend the plain meaning of 4 U.S.C. § 111 to avoid perceived hardships or inequitable results, the judgment below must be reversed.

CONCLUSION

The judgment of the Supreme Court of Virginia should be reversed and remanded for further proceedings to refund, within the applicable limitations period, all income taxes paid by Petitioners pursuant to Virginia's unlawful tax scheme in effect before *Davis*. Such action is necessary to enforce the plain terms of 4 U.S.C. § 111 and to ensure full compliance with the mandate of *McKesson* to provide meaningful backward-looking relief.

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The following is a complete list of all individuals appearing as *amici curiae* in connection with this brief:

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for themselves individually and as designated class representatives on behalf of a certified class of approximately 14,000 federal military retirees (and joint taxpayer spouses, where applicable) who have been subject to Kansas income taxation.

ARKANSAS *AMICI*

The petitioners in *Pledger v. Bosnick*, 811 S.W.2d 286 (Ark. 1991), *pet. for cert. pending*, No. 91-375, include:

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The petitioners in *Swanson v. State*, 407 S.E.2d 791 (N.C.), *adhered to on reh'g*, 410 S.E.2d 490 (N.C. 1991), *pet. for cert. pending*, No. 91-1436, include:

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MARGARET K. SWINK
JAMES E. SYKES
OLIVER B. TALBERT
JAMES D. TERRELL
CLYDE E. THOMAS
EMOGENE M. THOMPSON
FRED L. TRACY
ROCCO H. TROMBELLO
JOHN G. TRUITT JR.
WILLIAM H. TURK
JAMES T. VANCE
FRANCES A. VANDEN
GEORGE W. VANDEN
ETHEL D. VANHORN
EDWARD J. VAUGHN
EDWARD VENKLER
ROY L. VICK, SR.
KERMIT J. VINSON
MYRTLE H. VINSON
WILLIAM E. WALLACE
ROLAND J. WEBER
GRACE F. WEINER
LONA C. WEISNER
LAWRENCE O. WELCH
PAUL B. WELCH, JR.
GEORGE L. WESTERLIND
WILLIAM B. WHITE
T. M. WHITTINGTON, JR.
ROBERT S. WILLIAMS, JR.
WILLIAM C. WILLIAMS
WINTON H. WILLIAMS
HAROLD P. WILLIAMSON
EDNA MAE WILSON
ROBERT GRAVES WILSON, JR.
ERNEST G. WINSTEAD
PETER S. WONDOLOWSKI
ROBERT V. WOOD
MAYNARD B. WOODBURY
EVELYN W. WOODBURY
GEORGE W. WILKINS
JACK R. WORLEY
JOHN T. WORRELL
GEORGE T. WORRELL
GEORGE E. YALE, JR.
WILLIAM P. YARBOROUGH

for themselves individually and as designated class representatives on behalf of a certified class of approximately 100,000 federal military and civilian retirees who have been subject to North Carolina income taxation.

MONTANA *AMICI*

The petitioners in *Sheehy v. Montana*, 820 P.2d 1257 (Mont. 1991), *pet. for cert. pending*, No. 91-1473, include:

EDMUND SHEEHY;
RICHARD G. BRANCH;
MARGARET FLEMING;
GEORGE MCGOVERN;
CHARLES W. VANDIEST
ARNOLD S. WIRTALA;
AND
DONALD ZACK,

for themselves individually and on behalf of all other similarly situated federal military and civilian retirees who have been subject to Montana income taxation.

SOUTH CAROLINA *AMICI*

The petitioners in *Bass v. South Carolina*, 414 S.E.2d 110 (S.C. 1991), *pet. for cert. pending*, No. 91-1697, include:

FRANCIS EDWIN BASS, JR.;
JOHN GILREATH;
WILTON A. HOCKENBERRY;
J. LORING JENKINS;
MILDRED B. JENKINS;
MARVIN L. JONES; AND
CATHERINE L. MOYERS,

for themselves individually and as designated class representatives on behalf of a certified class of approximately 70,000 federal military and civilian retirees who have been subject to South Carolina income taxation.

NEW YORK *AMICI*

The appellants in *Duffy v. Wetzler*, 555 N.Y.S.2d 543 (N.Y. Sup. Ct. 1990), *aff'd as modified*, 579 N.Y.S.2d (N.Y. App. Div. 1992), *appeal dism'd*, (N.Y., Order, July 7, 1992), include:

EUGENE H. DUFFY
ALICE G. DUFFY;
ETTORE DELZIO;
VIVIAN DELZIO;
ALBERT ENGEL;
JUDITH ENGEL;
STANLEY L. GOLDSTEIN;
MILDRED GOLDSTEIN;
HARVEY GOTTLIEB;
PETER M. KALEY;
MARY T. KALEY;
DANIEL J. MAHER;
MARGARET A. MAHER;
FERNANDO S. MAURA;
THOMAS F. MOLLOY;
JOSEPH A. O'SULLIVAN;
RITA M. O'SULLIVAN;
JAMES SWEEZY;
ALICE SWEEZY;
IRVING WAX; AND
HELEN WAX.

UTAH *AMICI*

The cross-appellants in *Brumley v. Utah State Tax Commission*, No. 91-0242 (Utah, argued Apr. 7, 1992), include:

DRUE ALDOUS;
DERRAL ALLEN;
RICHARD ANDRUS;
DWIGHT BAERTSCH;
DOUG BALDWIN;
COLLEEN BALLOW;
MARGARET BATCHELOR;
KENNETH BELWOOD;
ALLEN BERGESEN;
ROBERT BIGSBEE;
LOUIS BONOMO;
NORMA BONOMO;
VERL BOSWORTH;
BARBARA BOWMAN;
BERM BOWMAN;
MARGARET BUSCHE;
MAY BUTTON;
BLAKE CHARD;
ARTWELL CHECKETTS;
BEATRICE CLAYTON;
SYBIL COLTER;
OLIVE COOMBS;
HAZEL COOPER;
MARILYN CORDON;
LEONARD COTTAM;
JAY CRAGUN;

BUFORD CRAWFORD;
MACK CROFT;
TOM CROSBY;
FERN DAVIS;
GARY DAVIS;
BERT DAYTON;
DON DEBOER;
WALT DEGN;
JOHN DEWEY;
LAMAR DEWEY;
CAROL DONNELLY;
FLORA ECK;
GLEN FERGUS;
ISADORA FETZR;
JETTA FILLIN;
ED FOURNIER;
BARBARA GARVEY;
JOSEPH GRANDUCCI;
LOIS GREEN;
THERON GREEN;
LYNN GROVES;
MARGARET HADLEY;
MARY HASSING;
LEANDER HENRY;
MARY HILLS;
BARBARA HOOPER;
CARLYLE JENSEN;
CHRIS JENSEN;
EVA JENSEN;
HAROLD JOHNSON;
ROBERT JONES;
ULAH JONES;
BYRON JORDAN;
JIM JOST;
RALPH KEITH;
MAX KENNEDY;
DAN KIMOSE;
STEVE KUDLA;
INA LAURITSEN;
MAYE LOEWEN;
JACK LOWERY;
VERNA MARKHAM;
LOLA MCFERSON;
ROY MCFERSON;
NINA MCQUARRIE;
CHARLES MILLER;
GLEN MILLER;
THOMAS MIZE;
EVERETT MOORE;
DONALD MOYER;
LAVONNE NANCE;
THAD NAPPER;
GUY NELSON;
KEITH NICHOLS;
CLYDE OLSON;
LEROY OLSON;
LAVON PALMER;
CARL PEARCE;
AXEL PEDERSEN;
GENE PENHRWOOD;
LEE PENHRWOOD;
RONALD PERCY;
DIETER POEHLER;
KENNETH REED;
KENNETH REED;
SHIRLEY REED;
SHIRLEY REED;
DONALD RENSCH;
KIRBY RICE;
PARIS ROBINSON;
AUBREY RUPEL;
RAD SAYMAN;
JACK SEAMONS;
SIDNEY SHARP;

DANIEL SHORT;
JACK SHURTLIFF;
DAWSON SIMPSON;
VIRGINIA SINGLETON;
HETTY SLY;
JOHN SNELL;
MYRA SNELL;
FRANK THEALL;
BILL THOMAS;
GRACE THORNTON;
MARY TOLLIVER;
GEORGE WAHLEN;
KIRT WALLING;
VINCENT WEST;
LAURA WICKHAM;
DON WILCOX;
GORDON WILLIAMS;
THOMAS WOOLWORTH;
IRENE C. ALLRED;
ARTELL B. ALLSOP;
DON F. ALLSOP;
ROBERT C. AMUNDSON;
KENNETH A. ANDERSON;
HOWARD D. ANDERSON;
ELLA M. ANDERSON;
ALBERT FRANCIS BAHR;
DURAN C. BAILEY;
RUTH E. BAILEY;
RUSSELL H. BALL;
CECIL G. BARGERON;
ROBERT B. BARKER;
H. ARCHIE BARNES, JR.;
LELAND H. BARTON;
FAUN J. BEESLEY;
FAWN J. BEESLEY;
JOHN E. BELL;
VERNON M. BERGSTROM;
JAMES K. BESSO;
RONALD K. BLIVEN;
JULIA E. BOBB;
WILLIAM E. BOEHLEN;
ROBERT H. BRACKEN;
DEAN C. BROWN;
WENDELL E. BRUMLEY
ROBERT S. BURTON;
WM. G. BUTLER;
ANNABEL L. BYRD;
LORNA M. CALL;
DEONE C. CANDLAND;
DAVID M. CANDLAND;
JOHN D. CARR;
R. H. CHANNEL;
GEORGE M. CHAPPLE;
CHARLES L. WALKER;
MARTHA J. CHASTAIN;
DON L. CHILD;
KENNETH A.
CHRISTENSEN;
VERNON A. CHRISTENSEN;
LEWIS K. CLARK;
DOYLE R. CLARK;
JACK S. CLARK;
WANDA B. CLAWSON;
WILLIAM C. CLAWSON;
GARTH M. COLTON;
SPENCER C. CONDIE;
OLIVE S. COONS;
HAZEL D. COOPER;
LEWIS R. COOPER;
LEWIS R. COOPER;
PAUL M. CROSBY;
JOHN L. DAVIS;
LT.COL. DEAN W. THORPE;
NORBERT V. DEBYLE;

ALBERT M. DEGERING;
SYLVESTER L. DIBELLA;
STANLEY L. DRANEY;
ALVIN D. DURRANT;
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ARNOLD T. ELLSWORTH;
HOLLIS T. FRANCOM
HOLLIS T. FRANCOM;
GEORGE B. FRY;
FRANCES C. FUNK;
ROBERT L. GARVEY;
LT. COL. GERALD E. DICKSON;
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IDA G. HARPOLE;
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EDWARD D. HAWKINS;
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LORRAINE P. HELGESEN;
LT. COL. HENRY HILLS;
DONALD J. HILDEBRAND;
LESTER G. HINCHCLIFF;
DELBERT L. HIRSCHI;
FRED A. HODAPP;
ELIZABETH H. HOELLEIN;
FRANCIS P. HOLST;
VIOLET B. HOOKER;
PAUL L. HOWARD;
ELNA M. HUILLET;
ALVIN C. HULL;
PHILLIP K. HUMPHREYS;
BOYD A. IVORY;
HOWARD M. IVORY;
CARL L. JENSEN;
DONALD R. JENSEN;
BESS T. JENSEN;
CHRISTINE T. JENSEN;
HARRY E. JOHNSON;
LUCILE S. JOHNSON;
CHARLEY A. JONES;
SAMUEL E. JORGENSEN;
MARTIN A. KASWORM;
A. GEORGE KATO;
JAMES T. KELLY;
CHARLES R. KING;
GLORIA C. KINNE;
E. WILLIAM KLEV;
JERRY G. KRZEMSKI;
DON R. LANGTON;
DONALD E. LAURITSEN;
LOUISE H. LEAKE;
THOMAS S. LEAKE;
JANE M. LEMMONS;
RICHARD C. LESSEY;
SHIRLEY DAN LOCKHART;
ROBERT E. LUDWIG;
JAMES T. LUHN;
JAMES N. LUND;
DALE A. MARTIN;
WILLIAM C. MARTIN;
ALLAN D. MCCOMB;
PATSY N. MCKELL;
ROBERT H. MCKINLAY;
ALBERT R. MCNAMEE;
COL. N.B. MECRARY;

JOHN W. MENEILL;
WILLIAM R. MILLER;
D. L. MONTGOMERY;
DARRELL L. MONTGOMERY;
CHERRIL H. NELSON;
JANE E. NICHOLS;
JAMES L. NIELSEN;
RUTH M. NIELSEN;
LYLE F. NIELSON;
EDWARD L. NOBLE;
WILLIAM P. NYE;
BOYD G. PARKER;
KARL G. PARKER;
KARL G. PARKER;
IRINTHA S. PARKER;
MICHAEL D. PATRICK;
BOYD W. PAUL;
SYDNEY C. PEACOCK;
ELTON J. PERRY;
RONALD W. PHELPS;
EVAN S. PICKETT;
J. MERLE PRINCE;
CHARLES L. PURVIS;
COL. JAMES R. JENNINGS;
FRANK D. REITER;
LULA CROFT,
representative for J.C. CROFT, deceased;
MARY TOLLIVER,
representative for: RICHARD TOLLIVER, deceased;
MAJ. GEN. REX A. HADLEY;
RODNEY C. RHODES;
ESTATE OF RICHARD M. TOLLIVER;
JOSEPH G. RICHARDSON;
KENNETH J. RIDDELL;
ROBERT G. RIDING;
CHARLES N. ROBERTSON;
COL. JAKE ROGERS;
C. O. ROWE;
EMMA L. RUGGLES;
MAESER M. RUSHTON;
ATHUS DELOSS RUSSELL;
MARGARET F. RUSSELL;
MAJ. JESSE S. WALKER;
MAJ. WM. S. SLEEPER;
JAMES R. SALVAGE;
GERALD D. SANDFORD;
BENJAMIN L. SCHAFER;
FRED L. SEPPI;
WILLIAM H. SEWARD;
WILLAM A. SHEEHAN;
WAYNE E. SHOOP;
DEAN T. SIGMAN;
PAUL A. SIMMONS;
RUTH B. SMITH;
MARY E. SMITH;
RUBY L. SMITH;
T. C. SPRATLEN;
FLEET L. STANTON;
MAXINE E. STEVENS;
NANCY G. STEWART;
HERBERT E. STRAND;
MACK D. SULLIVAN;
JAMES B. SWENSON;
LEIF A. SYVERSEN;
RICHARD P. SYVERSEN;
DONALD D. TAYLOR;
LEWIS D. TAYLOR;
ROBERT G. TAYLOR;
JAMES W. TAYLOR;
LAMAR W. TAYLOR;
T. C. TEASDALE;

MERLIN E. TEBBS;
LENA D. THEALL;
DON E. THOMAS;
ELVA A. THORNTON;
JOHN R. THUNELL;
CARMEN G. TICE;
DOROTHY T. TICE;
GLEN L. VANLEEUWEN;
VERNON E. VOSS;
GLENNA A. WALE;
RICHARD K. WEST;
KENNETH W. WESTERMAN;
EDWARD E. WIGGINS;
ROY E. WILLIAMSON;
MARVIN H. WOODBURY;
JACK L. WOODS;
M. G. WORKMAN;
R. J. YOUNGER;
EARNEST E. ZIMMERMAN;
MARILYN H. ZIMMERMAN,

for themselves individually and as designated class representatives on behalf of a certified class of approximately 34,000 federal military and civilian retirees who have been subject to Utah income taxation.

ALABAMA *AMICI*

The cross-appellees in *Sizemore v. Rinehart*, No. 2900290 (Ala. App. 1992), *pet. for cert. pending* (Ala., No.1911015), include:

EDMON L. RINEHART;
FRED MELOF; AND
CHARLES A. OLTS,

for themselves individually and as designated class representatives on behalf of a certified class of approximately 17,000 federal military retirees who have been subject to Alabama income taxation.

ARIZONA *AMICI*

The appellants in *Bohn v. Waddell*, 790 P.2d 772 (Ariz. T.C. 1990), *aff'd on reconsideration*, 807 P.2d 1 (Ariz. T.C. 1991), *appeal pending*, No. 1 CA-TX 90-029 (Ariz. App., argued Feb. 12, 1991), include:

ESTATE OF JOHN L. BOHN;
SHIRLEY BOHN;
DONALD RUTAN;
MARY RUTAN; AND
CARL LINTON,

for themselves individually and, under the doctrine of virtual representation on behalf of a certified class of approximately 70,000 federal military and civilian retirees who have been subject to Arizona income taxation.

APPENDIX B

The Supremacy Clause of the United States Constitution, Article VI, cl.2 provides:

> This Constitution, and the laws of the United States which shall be made in pursuant thereof; and all treaties made, or which shall be made, under the authority of the United States, shall be the supreme law of the land; and the judges in every state shall be bound thereby, anything in the Constitution or laws of any state to the contrary notwithstanding.

APPENDIX C

4 U.S.C. § 111 provides in pertinent part:

> The United States consents to the taxation of pay or compensation for personal service as an officer or employee of the United States...by a duly constituted taxing authority having jurisdiction, if the taxation does not discriminate against the officer or employee because of the source of pay or compensation.

MOTION FILED
AUG 12 1992

No. 91-794

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE AND BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF NEITHER PARTY

TIMOTHY J. MCCORMALLY
Counsel of Record
MARY L. FAHEY
TAX EXECUTIVES INSTITUTE, INC.
1001 Pennsylvania Avenue, N.W.
Suite 320
Washington, D.C. 20004-2505
(202) 638-5601
Counsel for Amicus Curiae
Tax Executives Institute, Inc.

WILSON - EPES PRINTING CO., INC. - 789-0096 - WASHINGTON, D.C. 20001

IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

MOTION FOR LEAVE TO FILE BRIEF AMICUS CURIAE ON BEHALF OF TAX EXECUTIVES INSTITUTE, INC. IN SUPPORT OF NEITHER PARTY OUT OF TIME

To the Honorable Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

Tax Executives Institute, Inc., by and through its counsel, Timothy J. McCormally, hereby moves this Court for leave to file Tax Executives Institute's Brief *Amicus Curiae* in Support of Neither Party in the above-captioned case out of time, and in support of this motion states, as follows:

1. That Timothy J. McCormally is General Counsel and Director of Tax Affairs for Tax Executives Institute, Inc. and Counsel of Record for the Institute;

2. That Tax Executives Institute, Inc. has obtained the written consents of both the Petitioners and the Re-

spondent to file a Brief *Amicus Curiae* in Support of Neither Party and that said consents have been filed with the Clerk of this Court;

3. That, pursuant to Rule 37.3 of the Rules of this Court, the Institute's brief was due to be filed at the same time as Petitioners' brief on the merits which was filed on July 17, 1992;

4. That, owing in part to oral and written communications with counsel for the Petitioners and Respondent, Mr. McCormally mistakenly believed that the Institute's brief was due to be filed at the same time as Respondent's brief on the merits and that a copy of the Institute's brief is enclosed with this Motion;

5. That Respondent's brief on the merits is currently due to be filed by September 8, 1992, and that on this 12th day of August 1992, copies of the Institute's brief are being filed with the Court, sent to both parties by messenger or by overnight-delivery service, and served by first-class mail.

WHEREFORE, it is respectfully requested that Tax Executives Institute's Motion for Leave to File a Brief *Amicus Curiae* in Support of Neither Party Out of Time be granted.

Respectfully submitted,

TIMOTHY J. MCCORMALLY
Counsel of Record
MARY L. FAHEY
TAX EXECUTIVES INSTITUTE, INC.
1001 Pennsylvania Avenue, N.W.
Suite 320
Washington, D.C. 20004-2505
(202) 638-5601
Counsel for Amicus Curiae
Tax Executives Institute, Inc.

August 12, 1992

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF TAX EXECUTIVES INSTITUTE, INC. AS AMICUS CURIAE IN SUPPORT OF NEITHER PARTY

INTEREST OF AMICUS CURIAE

Pursuant to Rule 37 of the Rules of this Court, Tax Executives Institute, Inc. respectfully submits this brief as *amicus curiae* in support of neither party.[1] Tax Executives Institute (hereinafter "TEI" or "the Institute") is a voluntary, non-profit association of corporate and other business executives, managers, and administrators who are responsible for the tax affairs of their employers. The Institute was organized in 1944 and currently has approximately 4,700 members who represent more than 2,000 of the leading corporations in the United States and Canada.

The members of the Institute represent a cross-section of the business community in North America, and the

[1] Tax Executives Institute has received the written consents of the Petitioners and Respondent to the filing of this brief; those consents have been filed with the Clerk of the Court.

companies represented by the Institute's membership are, almost without exception, engaged in interstate commerce. The Institute is dedicated to promoting the uniform and equitable enforcement of the tax laws throughout the Nation, to reducing the costs and burdens of administration and compliance to the benefit of both the government and taxpayers, and to vindicating the Commerce Clause and related Due Process and Equal Protection rights of all taxpayers.

This case addresses the extent to which a State may limit the application of a decision by this Court that a state tax statute violates the Constitution by choosing to apply that decision on a prospective-only basis. In 1989, the Court held in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), that 4 U.S.C. § 111 (1985) and the constitutional doctrine of intergovernmental tax immunity (as derived from the Supremacy Clause) prohibit the States from taxing federal annuitants more harshly than state annuitants. First in March 1991 and then again in November 1991, the Virginia Supreme Court, applying the standard set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), concluded that the Court's finding of unconstitutionality should apply on a prospective-only basis. Consequently, the Virginia court denied the Petitioners' claims for refunds in respect of the unconstitutionally imposed and collected taxes. 401 S.E.2d 868, 874 (Va. 1991), *reprinted at* Appendix C to Henry Harper's Petition for a Writ of Certiorari to the Supreme Court of Virginia (App.), at 17a (March 1, 1991, Decision of the Supreme Court of Virginia); 410 S.E.2d 629, 632 (Va. 1991), *reprinted at* App. A, at 5a (November 8, 1991, Decision of the Supreme Court of Virginia). It is this conclusion that Petitioners—federal annuitants—seek to overturn.

The Institute's members and the companies by whom they are employed have no direct interest in the resolution of this case, nor the consequent vindication or frustration of the constitutional doctrine of intergovernmental tax immunity. They do, however, have a keen and vital

interest in the resolution of the prospective-only issue. The Court's decision in this case promises to affect far more than the Commonwealth of Virginia's or other States' authority to retain the unconstitutional taxes they have collected from a discrete class of individual taxpayers. Indeed, the strength and vitality of this Court's holdings on Commerce Clause, Equal Protection, and Due Process issues may well be affected. If the Court does not clarify the standard to be used in determining whether a prior decision should be given retroactive effect, other States may well conclude that the Constitution does not bar either the *enactment* of tax statutes that discriminate against interstate commerce or even the *collection* of unconstitutional taxes *pendente lite*, but rather only the continual collection of such taxes after the unconstitutionality of the statutes is explicitly confirmed by the Court. Indeed, a disturbing trend in that direction can already be discerned. *See, e.g., Ashland Oil, Inc. v. Rose*, 350 S.E.2d 531, 536 & n.10 (W. Va. 1986) (the Court's decision in *Armco, Inc. v. Hardesty*, 467 U.S. 638 (1984), held to apply only to Armco), *appeal dismissed for want of final judgment*, 481 U.S. 1025 (1987), *rev'd sub nom., Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202, 3205 (1990) (per curiam). (*Armco* applies retroactively because case did not establish new principle of law); *National Can Corp. v. Washington Dep't of Revenue*, 749 P.2d 1286, 1287 (Wash.) (the Court's finding of unconstitutionality in *Tyler Pipe Industries v. Washington Department of Revenue*, 483 U.S. 232 (1987), held to apply on a prospective-only basis), *appeal dismissed and cert. denied*, 486 U.S. 1040 (1988).

Obversely, if the Court clearly enunciates the standard to be used in determining the retroactive effect to be given to decisions holding tax statutes to be unconstitutional, the rights of all taxpayers to be free from taxes that impose undue burdens on interstate commerce (or otherwise contravene the Constitution) will be vindicated and the Commerce Clause and other affected provisions of the Constitution will be vivified.

Because TEI members and the companies by whom they are employed will be materially affected by the application of the Court's decision, the Institute has a special interest in the outcome of this case.

SUMMARY OF ARGUMENT

This case addresses the extent to which a State may limit the application of a decision by this Court that a state tax statute violates the Constitution by choosing to apply that decision on a prospective-only basis. In 1989, the Court held in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989), that 4 U.S.C. § 111 (1985) and the constitutional doctrine of intergovernmental tax immunity prohibit the States from taxing federal annuitants more harshly than state annuitants. First in March 1991 and then again in November 1991, the Virginia Supreme Court concluded that the Court's finding of unconstitutionality should apply on a prospective-only basis. Consequently, the Virginia court denied the Petitioners' claims for refunds in respect of the unconstitutionally imposed and collected taxes. It is this conclusion that Petitioners—federal annuitants—seek to overturn.

The last decade has seen an almost unprecedented number of state taxing statutes struck down as unconstitutional. For example, in *Tyler Pipe Industries v. Washington Department of Revenue*, 483 U.S. 232, 248 (1987), the Court invalidated the multiple activities exemption of Washington State's business and occupation (B&O) tax as repugnant to the Constitution's Commerce Clause. Other decisions have struck down similarly flawed statutes. *See, e.g., James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2441 (1991) (invalidating Georgia's liquor excise tax); *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 46 (1990) (invalidating a similar statute in Florida); *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266, 286 (1987) (holding Pennsylvania's highway use tax unconstitutional); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 273 (1984) (holding Hawaii's exemption of local products from the liquor

excise tax unconstitutional); *Armco, Inc. v. Hardesty*, 467 U.S. 638, 645-46 (1984) (holding West Virginia's B&O tax contravened the Commerce Clause). Finally, in *Davis* the Court held that the constitutional doctrine of intergovernmental tax immunity and the applicable federal statute precluded the State of Michigan from taxing federal annuitants more harshly than it taxed state annuitants.

The States, however, have almost uniformly resisted efforts to refund the taxes that they had collected under invalidated laws. This refusal to pay refunds—or to fashion other meaningful remedies—has commonly been rationalized on equity grounds by applying the three-prong test set out in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971): (1) whether the decision establishes a new principle of law; (2) whether, based on the history of the rule in question, its purpose, and effect, the nonretroactive application will advance or retard the operation of the new rule; and (3) whether nonretroactive application is necessary to avoid injustice or hardship.

Amicus TEI believes that the decisional framework offered by *Chevron Oil* can be useful in assessing whether the Court's decisions should be given prospective-only effect. A properly applied *Chevron Oil* test will render a proper result. Regrettably, history teaches that many States may be unable or unwilling to apply the test in a prudent and constitutionally sound manner. The cumulative effect of the States' refusal to apply the decisions of this Court retroactively necessitates that the standard be clarified and strengthened. Absent such clarification, the principles and holdings of the Court's decisions may well be eviscerated, thereby leaving both the prevailing party and other taxpayers with a hollow victory.

Consider first *Chevron Oil's* "new principle" test: Did the Supreme Court decision striking down a state taxing scheme establish a "new" constitutional principle? The cases show that, from the States' perspective, "new" is in the eye of the beholder and anything that restricts the

States' taxing authority may be labelled as "new." Too frequently, the States define "new principle" simply to suit their needs.

Chevron Oil's second test addresses whether nonretroactive application of the new rule will advance or retard the operation of that rule. That the States routinely misapprehend the import of the standard is demonstrated by the state courts' decisions in *National Can Corp. v. Department of Revenue*, 749 P.2d 1286 (Wash. 1988), and *American Trucking Ass'ns v. Gray*, 746 S.W.2d 377 (Ark. 1988), as well as by the lower court opinions in this case. The courts in these cases failed to recognize that the purpose of constitutional adjudication is not merely to vindicate the rights of the litigants before the Court or even those of identically situated taxpayers. Rather, it is to effectively discourage future violations of those rights. Under the States' reading of *Chevron Oil's* purpose test, a ruling of unconstitutionality would never be applied retroactively.

The States' application of the inequity test in *Chevron Oil* is particularly troubling. Under *Chevron Oil*, the issue is whether prospective application is necessary to avoid injustice or undue hardship. The state courts have focused on the State's reliance on the unconstitutionally imposed and collected taxes, stating, for example, that "the expenditures made from this revenue . . . cannot be undone, and reimbursement at this point would pose a significant hardship upon the State's existing financial requirements." *National Can Corp., supra*, 749 P.2d at 1293. There are also references to the "unconscionable windfall" that the petitioners would purportedly receive if refunds were ordered. *American Trucking Ass'ns v. Gray*, 746 S.W.2d at 379.

Amicus TEI believes that the States' "windfall"/"inequity" analysis focuses on the wrong party. The issue is not whether a taxpayer might enjoy a benefit from lodging a successful challenge to an unconstitutional statute. Rather, it is whether there are factors present that, de-

spite the losing State's culpability, militate against the general rule of retroactivity. Thus, the inequity test measures the hardship or injustice that might befall the State and balances that hardship against the right (constitutional or economic) that would be fully vindicated only by the retroactive application of the decision.

Far too frequently, the States have ignored or misconstrued all three of *Chevron Oil*'s tests. Their failure to analyze *Chevron Oil* properly, if not rectified, could be used to sanction prospective-only application in respect of virtually all decisions declaring state tax statutes unconstitutional. Such a result would be pernicious—nullifying the Court's decisions on constitutional issues and frustrating the policy underlying the Commerce Clause, as well as the Equal Protection, Due Process, and Supremacy Clauses.

The States' application of *Chevron Oil* to a variety of cases confirms the need to clarify the applicable standard. The cases vividly illustrate that the States, at best, misunderstand the balance that is to be struck in considering the retroactivity question and, at worst, have virtually no regard for the policies underlying the Commerce Clause, Due Process Clause, and Equal Protection Clause, or for the precedents of this Court. In light of the States' repeated misapplication of the *Chevron Oil* standard, it may be appropriate for the Court not only to clarify and thereby vivify that standard, but to give consideration to the adoption of a new standard in respect of state tax statutes found to violate the Commerce Clause and other constitutional provisions. In criminal cases, the Court has already insisted on full retroactivity. *Griffith v. Kentucky*, 479 U.S. 314 (1987). Where the Commerce Clause or related Due Process or Equal Protection rights of taxpayers are implicated—or where, as here, the Supremacy Clause is involved and the litigant is not the United States but ancillary beneficiaries—a vivified *Chevron Oil* standard should permit prospective-only treatment only in rare cases. Because the States have it within their power to enact constitutional tax statutes,

they should be held to a higher standard in obtaining exceptions to the general rule of retroactivity. As the Court so forcefully proclaimed in *Griffith v. Kentucky*: "The time for toleration has come to an end." 479 U.S. at 323 (*quoting United States v. Johnson*, 457 U.S. 537, 555-56 n.16 (1982)).

ARGUMENT

I.

The last decade has seen an almost unprecedented number of state taxing statutes struck down as unconstitutional. For example, in *Tyler Pipe Industries v. Washington Department of Revenue*, 483 U.S. 232, 248 (1987), the Court invalidated the multiple activities exemption of Washington State's business and occupation (B&O) tax as repugnant to the Constitution's Commerce Clause. *See* U.S. Const. art. I., § 8, cl. 3. This decision was preceded by *Armco, Inc. v. Hardesty*, 467 U.S. 638, 645-46 (1984), in which the Court held that the State of West Virginia's B&O tax similarly contravened the Commerce Clause.

The Court was also impelled to strike down a state taxing scheme in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984), which involved the State of Hawaii's exemption of local products from the liquor excise tax. In that case, the Court concluded that the tax constituted unacceptable "economic protectionism" and therefore contravened the Commerce Clause. *Id.* at 273. This holding was reinforced by the Court's decisions in *McKesson Corp. v. Division of Alcoholic Beverages & Tobacco*, 496 U.S. 18, 46 (1990), and *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439, 2441 (1991), which struck down comparable statutes in Florida and Georgia, respectively.

In *American Trucking Ass'ns v. Scheiner*, 483 U.S. 266 (1987), the Court considered the constitutionality of Pennsylvania's highway use tax. It invalidated the law on the grounds that it impermissibly imposed a heavier tax burden on out-of-state businesses that compete in an interstate market than it imposed on its own residents

who also engage in commerce among the States.[2] *Id.* at 286.[3]

Finally, in *Davis v. Michigan Department of Treasury*, 489 U.S. 803, 817 (1989), the Court held that the constitutional doctrine of intergovernmental tax immunity, which is derived from the Supremacy Clause (U.S. Const. art. VI, cl. 2), and the applicable federal statute (4 U.S.C. § 111 (1985)) precluded the State of Michigan from taxing federal annuitants more harshly than it taxed state annuitants.[4]

In many ways these cases are dissimilar. They involved different types of statutes (though with the exception of *Davis*, they all implicated the Commerce Clause rights of interstate businesses).[5] There are, however, two attrib-

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[2] *See also Metropolitan Life Ins. Co. v. Ward*, 470 U.S. 869, 882-83 (1985) (holding unconstitutional the State of Alabama's discriminatory tax on foreign insurers).

[3] In *American Trucking Ass'ns v. Smith*, 496 U.S. 197 (1990), a divided Court declined to hold that its decision in *Scheiner* must apply retroactively.

[4] Twenty-two other States—including the Commonwealth of Virginia—had enacted laws similar to the one struck down in *Davis*. *Swanson v. North Carolina*, 407 S.E.2d 791, 792 (N. Car. 1991), *petition for cert. pending*, 60 U.S.L.W. 3655 (U.S. March 24, 1992) (No. 91-1436).

[5] There are at least two aspects of the present case that distinguish it from Commerce Clause cases. As already noted, this case involves the effective implementation of the Constitution's Supremacy Clause and, specifically, the constitutional doctrine of intergovernmental tax immunity. In some respects, the doctrine of intergovernmental tax immunity may be seen as more important than the Commerce Clause (or related constitutional provisions) because it affects the basic structure of the American system of government and the relationship of the federal government to the States. *See* Note, *Retroactivity of Refund Claims for Unconstitutional State Taxes: How Helpful is the* Chevron Oil *Test?* American Trucking Ass'n v. McNulty, United States v. City of Spokane, James B. Beam Distilling Co. v. Georgia, 45 Tax Lawyer 889, 895 (1992). For this very reason, however, the aggrieved taxpayers might properly be viewed as ancillary—rather than primary—beneficiaries of the constitutional provisions. In contrast, the very pur-

utes they share. First, they all involved a finding by this Court that the State had violated the Constitution in collecting a tax that was not imposed (or not imposed to the same extent) on a favored class of taxpayers (be they domestic businesses or state annuitants). Secondly, each of them triggered the same reaction by one or more States that imposed similarly unconstitutional taxes: a decision to apply the Court's holdings on a prospective-only basis. That is to say, even after the Court struck down the statutes as contravening the Constitution, the States resisted efforts to refund the taxes that they had collected under the invalidated laws.[6]

The States' refusal to pay refunds—or to fashion other meaningful remedies for taxpayers who have suffered the unconstitutional wrong—has commonly been rationalized on equity grounds. The States have essentially argued that the statutes at issue had been enacted in good faith, that the monies collected under those discriminatory statutes had already been spent, and that the issuance of re-

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pose of the Commerce, Due Process, and Equal Protection Clauses is to protect and vindicate the rights of individuals.

The second unique aspect of this case is the presence of a federal *statute*—4 U.S.C. § 111 (1985)—which was crafted with a much more specific purpose than provisions of the Constitution. Accordingly, the question exists whether the same standards—such as those enunciated by the Court in *Chevron Oil Co. v. Huson*, 404 U.S. 97, 106-07 (1971)—should even be applied to the retroactivity issue or rather, in furtherance of the Supremacy Clause, a more absolute rule should obtain.

[6] The refusal to apply the Court's holdings on a retroactive basis, however, has not been universal. For example, following the decision in *Davis*, courts in several States ordered refunds to be issued to affected federal annuitants. *Pledger v. Bosnick*, 811 S.W.2d 286, 292 (Ark. 1991), *petition for cert. pending*, 60 U.S.L.W. 3173 (U.S. Sept. 13, 1991) (No. 91-375); *Kuhn v. Colorado*, 817 P.2d 101, 110 (Colo. 1991), *cert. dismissed*, 112 S. Ct. 1925 (1992); *Hackman v. Director of Revenue*, 771 S.W.2d 77, 81 (Mo. 1989) (en banc), *cert. denied*, 493 U.S. 1019 (1990); *Burns v. New Mexico*, No. SF 89-1314(c) (1st Jud. Dist. Santa Fe County, April 5, 1990). *See also In re Schirck*, No. 90-5201 RPD (Tax Comm'r of W. Va., Sept. 23, 1991).

funds would threaten the fiscal well-being of the States. In reaching this result, the States have employed the analysis set forth in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971). In that case, the Court held that, in determining whether a decision should be applied on a prospective-only basis, the following three factors should be considered:

- *New Principle*: Whether the decision establishes a new principle of law or involves an issue of first impression whose resolution was not clearly foreseen.
- *Purpose*: Whether, based on the history of the rule in question, its purpose, and effect, the nonretroactive application will advance or retard the operation of the new rule.
- *Inequity*: Whether nonretroactive application is necessary to avoid injustice or hardship.

Id. at 106-07 (paraphrased).[7] *Accord American Trucking Ass'ns v. Smith*, 496 U.S. 167, 179 (1990). *See* Philip M. Tatarowicz, *Right to a Refund for Unconstitutionally Discriminatory State Taxes and Other Controversial State Tax Issues under the Commerce Clause*, 41 Tax Lawyer 103, 138-39 (1987).

Before turning to the standards set forth in *Chevron Oil*, however, *amicus* TEI wishes to emphasize that although the Constitution neither prohibits nor requires retrospective effect, *Linkletter v. Walker*, 381 U.S. 618,

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[7] The *Chevron Oil* case itself did not involve the retroactive effect to be given to a ruling of *unconstitutionality*. Rather, the case addressed the reach of a decision that Louisiana's statute of limitations governed claims for personal injuries sustained on the Outer Continental Shelf off the coast of Louisiana. In *Chevron Oil*, the Court held that its decision in *Rodrigue v. Aetna Casualty & Surety Co.*, 395 U.S. 352 (1969), should not apply retroactively to litigants who had relied on several federal cases holding that admiralty law (specifically, the doctrine of laches) controlled the issue. 404 U.S. at 107-09. In *Griffith v. Kentucky*, 479 U.S. 314 (1987), which changed the analysis to be used in criminal procedure cases, the Court stated that *Chevron Oil* continued to govern civil cases. 479 U.S. at 322 n.8.

629 (1965), the rule remains that "a legal system based on precedent has a built-in presumption of retroactivity." *Solem v. Stumes*, 465 U.S. 638, 642 (1984). *Accord Saint Francis College v. Al-Khazraji*, 481 U.S. 604, 608 (1987). *See generally* Lawrence H. Tribe, *American Constitutional Law* 29-30 & n.20 (2d ed. 1988); John E. Nowak & Ronald D. Rotunda, *Constitutional Law* § 11.9, at 412 412 n.28 (4th ed. 1991).[8] Although exceptions to the rule of retroactivity may be recognized as a matter of policy, the exceptions should be narrowly construed: they should not swallow the rule.[9] Thus, the *Chevron Oil* construct is an instrument to be wielded cautiously. If it is not, the principles and holdings of the precedent to which it is being applied (*e.g.*, the ruling in *Davis* in the instant case) may well be eviscerated, thereby leaving both the prevailing party and other taxpayers with a hollow victory.

Amicus TEI also wishes to stress that the choice-of-law principle set forth by this Court in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991), may restrict or preclude the application of the *Chevron Oil* standard in particular cases. In *Beam*, Justice Souter wrote for the Court that—

> [W]hen the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata.

111 S. Ct. at 2448. Thus, if the Court in the original action applies its holding to the parties then before the Court, the earlier case "should be read as having retroactively applied the rule there decided." *Id.* at 2445 (foot-

[8] The general rule can be traced to Blackstone. 1 William Blackstone, *Commentaries* *70-71; *see Norton v. Shelby County*, 118 U.S. 425, 442 (1886); *United States v. The Schooner Peggy*, 5 U.S. (1 Cranch) 103, 110 (1801).

[9] *See EEOC v. Vuitech*, 842 F.2d 936, 941-42 (7th Cir. 1988) ("[t]he presumption [is] strongly in favor of retroactive application").

notes omitted). The Court's rejection of "selective prospectivity" should thus be seen to vindicate the general rule of retroactivity while not precluding the application of *Chevron Oil* in an appropriate, albeit narrower, class of cases.

II.

Amicus TEI believes that the decisional framework offered by *Chevron Oil* can indeed be useful in assessing whether the Court's decisions should be given prospective-only effect. A properly applied *Chevron Oil* test will render a proper result. Regrettably, history teaches that many States may be unable or unwilling to apply the test in a prudent and constitutionally sound manner. Indeed, too many of the States have chosen to interpret the three prongs of the Court's holding in a self-serving, result-oriented manner. As the matter now stands, the States in their quest for revenue have transmogrified the three-part test of *Chevron Oil* into a standard so pliable that virtually all rulings of unconstitutionality could be applied, at a State's choosing, on a prospective-only basis. Whereas a nonretroactive result in a given case may not, by itself, manifest a need to supplant *Chevron Oil*, the cumulative effect of all the States' actions necessitates that the standard be clarified and strengthened.

A. Did the Prior Decision Establish A New Principle?

Consider first *Chevron Oil*'s "new principle" test: Did the Supreme Court decision striking down a state taxing scheme establish a "new" constitutional principle? 404 U.S. at 106.[10] From the States' perspective, "new" is in the eye of the beholder and, as the beholder, the States have

[10] The first *Chevron Oil* factor is, of course, a threshold requirement for prospective-only treatment: *if the principle was extant at the time of the decision, then the decision must be applied retroactively. See United v. Johnson*, 457 U.S. 537, 550 n.12 (1982) (if this "new principle" standard is not met, *Chevron*'s other two factors need not be considered; the decision will be applied retroactively).

too routinely labelled anything that stands in the way of their taxing authority as "new."

For example, in *National Can Corp. v. Department of Revenue*, 749 P.2d 1286 (Wash.) (en banc), *appeal dismissed and cert. denied*, 486 U.S. 1040 (1988), the Washington court nimbly concluded that the Court's decision in *Tyler Pipe*, *supra*, represented a clear break from prior rulings, even though those prior rulings were expressly relied on by the Court in *Tyler Pipe*. 749 P.2d at 1288-90; *see Tyler Pipe*, 483 U.S. at 241-43 (citing, among others, *Armco, Inc. v. Hardesty*, *supra*; *Boston Stock Exch. v. State Tax Comm'n*, 429 U.S. 318 (1977); and *Maryland v. Louisiana*, 451 U.S. 725 (1981)). What did the Washington Supreme Court cite to support its reading of prior precedent? It cited its own ruling in *National Can Corp. v. Department of Revenue*, 715 P.2d 128 (Wash. 1986) (opinion later corrected for technical reasons and reported at 732 P.2d 134), as evidence that *Armco* did not foreshadow the result in *Tyler Pipe*. 749 P.2d at 1289. It was that very decision, however, that *Tyler Pipe* reversed![11] To conclude that a State's own misreading of precedent vitiates its responsibility to follow that precedent would itself represent a clear break from sound and established principles of adjudication and could send a disturbing signal to all the States: perhaps ignorance of the law *is* an excuse.[12]

[11] *See* 483 U.S. at 232 ("We conclude that our reasons for invalidating the West Virginia tax in *Armco* also apply to the Washington tax challenged here."). In deciding not to apply *Tyler Pipe* retroactively, the Washington court also relied heavily on the decision of the West Virginia Supreme Court in *Ashland Oil Co. v. Rose*, *supra*, which was subsequently reversed by this Court in a *per curiam* opinion in *Ashland Oil Co. v. Caryl*, *supra*. 749 P.2d at 1292-94.

[12] *See Chapman v. California*, 386 U.S. 18, 21 (1967) (criminal procedure case) ("we cannot leave to the States the formulation of the authoritative laws, rules, and remedies designed to protect people from infractions by the States of federally guaranteed rights").

Similarly, in *American Trucking Ass'ns v. Smith*, *supra*, the Arkansas Supreme Court averred that *Chevron Oil*'s first test focuses on "whether it was reasonable for the state to have conducted itself as it did" or whether "a reasonable person could easily have found [the tax] to pass Commerce Clause muster." *American Trucking Ass'ns v. Gray*, 746 S.W.2d 377, 378 (Ark. 1988) (refusing to apply *Scheiner* retroactively). Clearly, however, that is *not* the standard. Rather, the first factor asks whether the decision overruled "clear past precedent" or involved "an issue of first impression whose resolution was not clearly foreshadowed." *Chevron Oil*, 404 U.S. at 106. In light of the Court's earlier decision in *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977), the 1987 ruling of unconstitutionality in *Scheiner* can be said to have been clearly foreshadowed. *American Trucking Ass'n v. Kline*, No. 07-14-1667-85MVT (N.J. Tax Ct. Sept. 8, 1988) (unpublished opinion).[13]

Finally, in the instant case, the Virginia Supreme Court cited (among other cases) this Court's 1983 decision in *Memphis Bank & Trust Co. v. Garner*, 459 U.S. 392, 395 (1983), which struck down on intergovernmental tax immunity grounds a state taxing scheme that imposed greater burdens on holders of federal obligations than on holders of similar state obligations, and its 1960 decision in *Phillips Chemical Co. v. Dumas Independent School District*, 361 U.S. 376, 379 (1960), which held that a state tax that imposes a greater burden on the lessees of federal property than on lessees of other exempt public property impermissibly discriminates against the federal government. Nevertheless, the state court concluded:

[13] In *Kline*, the New Jersey Tax Court held that *Scheiner* should be applied retroactively. The court stated that "[e]ven if *Complete Auto Transit* did not specifically overrule the [cases on which the Arkansas court in *Scheiner* had relied] . . . the invalidity of flat taxes which discriminate as a matter of practical effect was clearly foreshadowed by *Complete Auto Transit*." Slip Op. at 9.

> [I]t is difficult to discern how the General Assembly of Virginia should have been expected to perceive that a statutory scheme, exempting state pensioners from state taxation, would have placed any foreseeable and direct burden on some federal operation.

App. C, at 12a. Such a conclusion, moreover, came despite the clear statement in *Phillips Chemical Co.* that a State must treat "those who deal with the [Federal] Government"—the federal pensioners here—"as well as it treats those with whom it deals itself"—the state pensioners. 361 U.S. at 385.[14]

That the States' application of *Chevron Oil*'s new principle test is driven more by their desire to deny responsibility for their unconstitutional acts than by a reasonable interpretation of that case is perhaps best illustrated by the brief *amici curiae* that Virginia and 28 States, the District of Columbia, Guam, and the Virgin Islands filed last term in *Allied-Signal, Inc. v. Director, Division of Taxation*, 112 S. Ct. 2251 (1992).[15] In that case, which involved the potential overruling of two Supreme Court decisions—*ASARCO Inc. v. Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co. v. Taxation & Revenue Department*, 458 U.S. 354 (1982)—the Court invited briefs on whether any such overruling should be retroactive. Although the case would have involved the overruling of express and directly applicable Supreme Court precedent of less than ten years' duration (which itself relied on an unbroken chain of Supreme Court decisions dating back to 1875), the States had no problem in boldly arguing that "the *Chevron Oil* test can accommodate both an overruling decision and a holding of retroactivity." Brief by Alabama, *et al.*, *Allied-Signal, Inc. v. Director, Division of Taxation*, *supra*, at 16. Such an "accommodation," however, seems completely untethered by consistency. Hence, for the States, the coin of the realm frequently seems not to be principle but greed.

[14] *See United States v. City of Spokane*, 918 F.2d 84, 89 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 2888 (1991) (city tax on the local Red Cross—an instrumentality of the United States—struck down and decision applied retroactively; the court found the city's defense unpersuasive on the grounds that, in view of the strong constitutional prohibition against state governments' taxing federal instrumentalities, the city should have had doubts about the propriety of its action).

[15] Brief by Alabama, Arizona, Arkansas, Colorado, District of Columbia, Florida, Georgia, Guam, Indiana, Kentucky, Louisiana, Michigan, Mississippi, Montana, Nebraska, Nevada, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, South Dakota, Texas, Utah, Virgin Islands, Virginia, Washington, West Virginia, Wisconsin, and Wyoming as Amici Curiae in Support of Respondent, *Allied-Signal, Inc. v. Director, Division of Taxation*, 112 S. Ct. 2251 (1992) (No. 91-615).

Where the Court expressly overrules one of its own decisions (as the State of New Jersey proposed in *Allied-Signal*), the new principle prong of *Chevron Oil* is manifestly satisfied: the new decision represents a clear break with the past. Nonretroactivity would seem especially compelling where the case involves a dilution of taxpayers' Commerce Clause or other constitutional rights (not their enhancement). In such cases (unlike the situation where the Court invalidates a state tax statute), there is no question of constitutional wrongdoing by the losing litigant, but rather the potential sanctioning of a scheme of state taxation that previously was found to contravene the Constitution. Thus, the adversely affected taxpayers would not have been found to have violated a legal or constitutional duty or to have impaired the Due Process, Equal Protection, and Commerce Clause rights of any one. *Cf.* Richard H. Fallon, Jr. & Daniel J. Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1731, 1745 (1991) ("[a] basic asymmetry exists between decisions contracting and those expanding the domain of individual rights."). In other words, where the Court moves to constrict the protections afforded by the Constitution, it should do so on a retro-

active basis.[16] As Justice Scalia wrote in *Quill Corp. v. North Dakota*, 112 S. Ct. 1904 (1992), "we ought not visit economic hardship upon those who took us at our word." *Id.* at 1924 (Scalia, J., with Kennedy & Thomas, J.J., concurring).

The State *amici* in *Allied-Signal* noted that "[i]f the Supreme Court overrules a precedent under which a state tax statute would have been unconstitutional, it is the taxpayer whose reliance interest will be unsettled by a fully retroactive application of the decision" and concluded that "[i]n some instances, retroactive taxation may be a fair result; in other instances, it clearly will not be." Brief by Alabama, *et al.*, *Allied-Signal, Inc. v. Director, Division of Taxation*, *supra*, at 17, 18. Nevertheless, the States too often have defined "fair" as they define "new principle": to suit their needs.

B. Would Prospective-Only Treatment Advance or Retard the Operation of the New Rule?

Chevron Oil's second test addresses whether nonretroactive application of the new rule will advance or retard the operation of that rule. 404 U.S. at 106-07. That the States systematically misapprehend the import of the standard is demonstrated by the state courts' decisions in *National Can* and *American Trucking Ass'ns v. Smith*, as well as by the lower court opinion in this case.

[16] Whereas retroactive application of decisions holding particular taxes unconstitutional—such as in *McKesson*—provides a clear incentive for States to avoid unconstitutional taxes, Fallon & Meltzer, *supra*, at 1829, the opposite incentive would be provided by the retroactive overruling of taxpayer-favorable precedent: the States would be encouraged to disregard this Court's clear holdings and to construct taxing schemes that run contrary to long-established principles such as the unitary business principle. Such an occurrence would be tremendously disruptive. Nothing would be settled and the States would be continually emboldened to impose unconstitutional taxes on the chance that, one day, this Court might relent in its reasoned interpretation of the Constitution's Due Process, Equal Protection, and Commerce Clauses.

In the Arkansas case, the court blithely quoted the Washington Supreme Court in *National Can*, as follows:

> It is difficult to understand how retroactive application would encourage free trade among the states since whatever chill was imposed on interstate commerce is in the past. . . .

American Trucking Ass'ns v. Gray, 746 S.W.2d at 379 (quoting *National Can Corp.*, 749 P.2d at 1291).

In the instant case, the Virginia Supreme Court took a different tack. It argued that retroactive application of the *Davis* decision was unnecessary to advance the principle of intergovernmental tax immunity because the Commonwealth of Virginia promptly stopped its unconstitutional practice of discriminating against federal annuitants after the *Davis* decision:

> As soon as the General Assembly became aware of the *Davis* decision, it acted to correct the defects in its statute. . . . As a result, the purpose of the intergovernmental tax immunity doctrine already has been fully served, and applying *Davis* retroactively would do nothing either to retard or to further the doctrine's purpose.

App. C, at 12a.

The courts in these cases, however, fail to recognize that the purpose of constitutional adjudication is not merely to vindicate the rights of the litigants before the Court or even of identically situated taxpayers. The purpose is to effectively discourage future violations of those rights. Under the States' reading of *Chevron Oil*'s purpose test—assuming the absence of "massive resistance" by the States—a ruling of unconstitutionality would never be applied retroactively, for the States would presumably always relent (eventually) when the Court held against them. At the same time, however, the States would have an incentive to enact unconstitutional statutes—to "roll the dice" with the constitutional rights of taxpayers, knowing that—at worst—they may have to mend their

ways in the future.[17] The overall result, therefore, could not help but frustrate the very principles the core decision was intended to guarantee. Indeed, an excessively loose interpretation of *Chevron Oil* would likely dissuade taxpayers from contesting the constitutionality of dubious state taxing schemes by depriving them of any economic benefit from a successful challenge. The failure of the Court to accord taxpayers anything more than a pyrrhic victory would assuredly chill efforts to secure their Commerce Clause and related rights.[18]

C. Is Prospective-Only Application Necessary to Avoid Injustice or Hardship?

The States' discussion of the inequity test in *Chevron Oil* is particularly troubling. Under *Chevron Oil*, the issue is whether prospective application is necessary to

[17] *See* Tatarowicz, *supra*, 41 Tax Lawyer at 141-42 ("the practical effect [of prospective-only application] would be to permit states the financial benefits of discriminatory taxation. A state could enact tax laws without concern for constitutional limitation, knowing that, if such laws were ultimately found to discriminate against interstate commerce, they could be repealed with impunity. . . . [T]he prospective application of a finding of unconstitutionality retards the purpose of the commerce clause by offering the inducement of a clear financial advantage to those states that violate it.").

[18] In addition, the States' denial of refunds could disrupt the tax administrative practice in the States by encouraging taxpayers not to pay the suspect tax (rather than to pay the tax and then claim a refund). For example, *amicus* TEI understands that following this Court's recent decision in *Kraft General Foods, Inc. v. Iowa Department of Revenue & Finance*, 112 S. Ct. 2365 (1992), the State of Iowa issued a refund to the litigant, and dropped its claims against taxpayers that refused to pay the unconstitutional tax; however, the State, to date, has declined to pay refunds to similarly situated taxpayers that paid the tax and subsequently filed claims for refund. Telephone Interview with John V. Donnelly, Counsel for Kraft General Foods, Inc. (Aug. 4, 1992). Such a practice, which seems inconsistent with *Beam*'s proscription on selective prospectivity, will not only disadvantage those taxpayers that followed the States' prescribed refund procedure but also impel taxpayers to avoid the situation in the future by refusing to pay the tax in the first instance.

avoid injustice or undue hardship. 404 U.S. at 107. In *National Can*, the Washington court focused on the State's "reliance" on the unconstitutionally imposed and collected taxes, stating that "the expenditures made from this revenue . . . cannot be undone, and reimbursement at this point would pose a significant hardship upon the State's existing financial requirements." 749 P.2d at 1293.

Similarly, in *American Trucking Ass'ns v. Smith*, the Arkansas court raised the specter of a hardship in referring to the State's having spent or "counted on" the collected unconstitutional taxes. 746 S.W.2d at 379.[19] It also made reference to the "unconscionable windfall" that the petitioners would receive if refunds were ordered, *id.*, an argument that the Florida Supreme Court invoked in *Division of Alcoholic Beverages & Tobacco v. McKesson Corp.*, 524 So. 2d 1000, 1010 (Fla. 1988) (references to "equitable considerations" and to the "windfall" petitioners would "in all probability" receive, on the assumption that the unconstitutional taxes had been passed on to customers).

In the instant case, the Virginia Supreme Court also discussed "the effect that retroactive application of a judicial decision may have on a state's financial stability." App. C, at 13a. The court explained:

> [R]etroactive application of the *Davis* decision would give rise to a potential tax refund liability, inclusive of interest, of approximately $440,000,000. This liability would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits. The record . . . support[s] the conclusion that allowing the requested refunds would have a potentially

[19] That the State of Arkansas had already expended the unconstitutional taxes, or at least taken them into account for budgeting purposes, was the court's justification for refusing to order refunds of the taxes collected during a period commencing with the Court's decision in *Scheiner* and the establishment of an escrow account. 746 S.W.2d at 378-79.

> disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services.

App. C, at 13a-14a (citations omitted).[20]

Amicus TEI believes that the States' "windfall"/"inequity" analysis focuses on the wrong party. The issue is not whether an aggrieved taxpayer might enjoy a benefit from lodging a successful challenge to an unconstitutional statute; that is often the case. Rather, it is whether there are factors present that, despite the losing State's culpability, militate against the general rule of retroactivity. Thus, the inequity test measures the hardship or injustice that might befall the State and balances that hardship against the right (constitutional or economic) that would be fully vindicated only by the retroactive application of the decision.

Under a properly framed inequity test, there should be no doubt that the "hardship" endured by the States—its required refund of unconstitutional taxes that had been "counted on"—should generally not pass muster. Indeed, if such a "hardship" were deemed sufficient to justify prospective treatment, unconstitutional tax statutes would rarely, if ever, be overturned retroactively. States invariably spend the revenues they collect. The sounder approach is to examine whether *undue* hardship would result from retroactive application of a decision. Under such an analysis, a different result will generally obtain, for the "hardship" of which the States might complain is one of their own making—the result of their own unconstitutional acts.[21] Thus, the large amount of refunds

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[20] There is no question whether the taxpayers in the instant case have "passed on" the discriminatory tax that was imposed on them. They clearly did not and, hence, could not possibly enjoy any "windfall" if refunds are ordered.

[21] For example, in the *Tyler Pipe* case, the state court refused to enjoin collection of the taxes prior to a decision on the merits on the grounds that the taxpayers' right to a refund would be an adequate remedy if the taxpayers prevailed. *Tyler Pipe Indus. v. Department of Revenue*, 638 P.2d 1213, 1214, 1216 (Wash. 1982). When the taxpayer did prevail on the merits, the Washington Supreme Court refused to order refunds based on the alleged "hardship" such refunds would cause the State. *National Can Corp.*, 749 P.2d at 1293. In point of fact, however, any "hardship" could have been substantially mitigated had the State heeded the advice of its own Director of Revenue who, two days after this Court's decision in *Armco*, advised the Governor that "the reasoning of the Court in the *Armco* decision is clearly applicable to our statutory arrangement . . . ." Memorandum to the Honorable John Spellman, Governor, from Donald R. Burrows, Washington State Director of Revenue (June 14, 1984), *reprinted at* Exhibit F of the Appendix to Jurisdictional Statement of Appellants National Can Corporation, *et al.*, at 80a, *National Can Corp. v. Washington Dep't of Revenue*, 486 U.S. 1040 (1988) (No. 87-1629) (*cert. denied*). Had the Director's concern been acted upon, the collection of unconstitutional taxes could have ended more than three years before the Court's decision in *Tyler Pipe*. Instead, the State continued its efforts to enforce the discriminatory taxes in violation of the Commerce Clause, thereby exacerbating the "hardship" of which it subsequently complained.

at issue in this case was not determined in an arbitrary, willy-nilly fashion: it is the precise amount of tax that was unconstitutionally exacted from aggrieved taxpayers.

What is more, the States are not without power to address any resulting revenue shortfall. Clearly, they are empowered to levy and collect taxes equal to the amount of any refunds. The question is whether the fiscal hole is to be filled through constitutional or unconstitutional means. *Amicus* TEI suggests that to pose the question is to answer it.

In this regard, it is instructive to consider those cases in which the Court has provided relief under the inequity prong of the *Chevron Oil* test (or comparable standards). For example, in *Lemon v. Kurtzman*, 411 U.S. 192 (1973) (*Lemon II*), the Court limited the effect of its decision two years earlier in *Lemon v. Kurtzman*, 403 U.S. 602, 625

(1971) (*Lemon I*), which invalidated, on First Amendment grounds, a Pennsylvania statute authorizing State reimbursement to private sectarian schools for certain educational services provided by the schools. 411 U.S. at 207-09. The hardships with which the Court was concerned in that case were not the State's but rather the private schools that had provided services and incurred expenses in reliance on the constitutionally defective statute. *Id.* at 203-04. Indeed, the State would have been relieved of a financial burden had the Court applied its decision on a retroactive basis.

Similarly, in *Cipriano v. City of Houma*, 395 U.S. 701 (1969), the Court limited the retroactive effect of a decision holding unconstitutional a Louisiana statute permitting only property taxpayers to vote in elections called to approve the issuance of public utility revenue bonds. The hardship addressed by the Court was again not the State's but that which would have been suffered by cities and bondholders (who had relied on the state law) had the decision been applied retroactively. *Id.* at 706.[22]

Thus, in applying the inequity test, the Court has focused on whether hardship would befall parties or other individuals who did not have it within their power to rectify the situation by adopting the rule in question. The States clearly have the power to enact constitutional, nondiscriminatory tax statutes. That they choose not to,

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[22] *See also Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87-88 (1982) (decision holding the Bankruptcy Act of 1980 unconstitutional applied prospectively because of the substantial injustice and hardship that would otherwise be visited upon litigants who had relied on the statute); *Los Angeles Dep't of Water & Power v. Manhart*, 435 U.S. 702, 722-23 (1978) (decision that city department's employee benefit plan violated Title VII of the Civil Rights Act of 1964, as amended, applied prospectively because of "devastating" effect retroactivity could have "in large part on innocent third parties"—the covered employees).

should not grant them license to retain their ill-gotten gains.[23]

Moreover, even assuming the States could demonstrate that they would suffer an undue hardship if compelled to refund immediately all unconstitutionally collected taxes, it does not follow—as many States have alleged—that the wronged taxpayers should receive nothing.[24] In appropriate cases, a State might—perhaps under guidelines prescribed by the legislature—craft a refund policy that minimizes the "inequity" otherwise incurred. For example, a State might provide that the taxes unconstitutionally collected (plus an interest factor) could be claimed as a credit on the affected taxpayers' future years' tax returns.[25]

In summary, far too frequently, the States have ignored or misconstrued all three of *Chevron Oil*'s tests. Their failure to analyze *Chevron Oil* properly, if not rectified, could be used to sanction prospective-only application in respect of virtually all decisions declaring state tax statutes unconstitutional. Such a result would be pernicious

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[23] As Justice Mitchell so aptly put it in *Swanson v. North Carolina*, *supra*, "[t]here simply is nothing 'inequitable' or wrong about ordering that the State not pick a taxpayer's pocket or in requiring it to return the money when it is caught doing so." 407 S.E.2d at 797 (Mitchell, J., dissenting). *See also id.* ("I am unable to see the 'inequity' involved in requiring the State to return any money it has unconstitutionally taken from the plaintiffs."); *Sheehy v. Montana*, 820 P.2d 1257, 1269 (Mont. 1991) (Trieweiler, J., dissenting) ("What is equitable about allowing the State, with all its power, to illegally seize someone's property, and then after being told what it did was illegal, allowing the State to keep it?"), *petition for cert. pending*, 60 U.S.L.W. 3675 (U.S. March 31, 1992) (No. 91-1473).

[24] Obviously, the hardship suffered by the States in such an instance would be no greater than the hardship collectively suffered by the taxpayers from whom the taxes were unconstitutionally exacted.

[25] Tatarowicz, *supra*, 41 Tax Lawyer at 143 & n.248. Alternatively, the taxes at issue could be refunded in installments. 41 Tax Lawyer at 143.

—nullifying the Court's decisions on constitutional issues and frustrating the policy underlying the Commerce Clause, as well as the Due Process, Equal Protection, and Supremacy Clauses.

III.

Although the instant case involves unique questions related to the purpose and scope of the Supremacy Clause and the doctrine of intergovernmental tax immunity, the governing principles potentially have broad application to a whole range of cases involving the validity of state taxing schemes under the Commerce, Due Process, and Equal Protection Clauses. Indeed, the instant case represents only the most recent testimony of the need to clarify the *Chevron Oil* standard in order to vindicate basic constitutional principles. In recent years there has been a veritable wave of state court decisions in which discriminatory statutes have been found, in essence, to be unconstitutional on a prospective-only basis. Among the States that have held this Court's precedents to have little or no retroactive effect are West Virginia, Michigan, Washington, New Jersey, North Dakota, Kentucky, Oklahoma, Ohio, Florida, New York and Arizona.[26]

These cases vividly illustrate that the States, at best, misunderstand the balance that is to be struck in considering the retroactivity question and, at worst, have virtually no regard for the policies underlying the Commerce Clause, Due Process Clause, and Equal Protection Clause, or for the precedents of this Court. State after State has adopted what can be described as a "heads I

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[26] For a list of cases in which state courts have applied decisions that a tax is unconstitutional on a prospective-only basis, see Tatarowicz, *supra*, 41 Tax Lawyer at 117-18 n.89. Not all States have refused to accord the Court's decisions retroactive effect. *Compare American Trucking Ass'ns v. Goldstein*, 541 A.2d 955, 961 (Md. 1988) (overturning the State of Maryland's effort to postpone the effective date of the *Scheiner* decision for a nearly a year); *American Trucking Ass'n v. Kline*, *supra* (*Scheiner* applied retroactively); *American Trucking Ass'ns v. Conway*, 566 A.2d 1235, 1340-42 (Vt. 1989) (*Scheiner* applied retroactively).

win, tails you lose" approach to cases implicating the Constitution's proscription on discriminatory tax statutes. If a State prevails in litigation and the challenged statute is sustained, all taxpayers (rightfully) lose. But if a State loses and the statute is found to be constitutionally deficient, the State then declares that the decision established a "new principle" and, therefore, that it should receive prospective-only application. As a result, all taxpayers (with the possible exception of the victorious litigant who in any event may have incurred substantial costs) lose.

Perhaps most objectionable is the States' distending the equity prong of *Chevron Oil*. The States' argument that they have "already spent the money" parallels that of the child who murders his parents and then throws himself on the mercy of the Court as an orphan. *Amicus* TEI recognizes that the analogy is not wholly apt and that the fiscal straits in which the States find themselves are not to be cavalierly dismissed. Nor, however, should they excuse concededly unconstitutional acts. The States should not be free to pass unconstitutional laws, to exact tribute from taxpayers in a discriminatory manner, to spend the money, and then, when caught, to plead poverty.

The States' protestations of good faith, their adroit reading of precedent, and their deft, self-serving application of *Chevron Oil* may enrich their fisces, but the results can hardly be said to foster the policy underlying the Constitution (and, in particular, the Commerce Clause). Unless the *Chevron Oil* standard is clarified, not only may States be emboldened to ignore constitutional concerns but taxpayers may also be discouraged from challenging clearly discriminatory tax statutes.

Hence, this Court should end its willing suspension of disbelief. Time and time again this Court has held state taxing schemes unconstitutional and remanded the cases for action "not inconsistent with this opinion." *E.g.*, *Tyler Pipe*, 483 U.S. at 253. And time and time again,

the States have demurred, effectively averring that a constitutional consistency is the hobgoblin of compliant minds.[27] The wave of prospective-only holdings that have ensued fail the test of consistency—with respect both to constitutional principles and the Court's teaching in *Chevron Oil*. It should be stopped.

IV.

Amicus Tax Executives Institute respectfully submits that, in light of the States' repeated misapplication of the *Chevron Oil* standard, the Court might properly not only clarify and thereby vivify that standard, but also give consideration to the adoption of a new standard in respect of state tax statutes found to violate the Commerce Clause.

In Griffith v. Kentucky, 479 U.S. 314 (1987), this Court considered—and found constitutionally repugnant—the racially discriminatory use by prosecutors of peremptory challenges. Declaring that "[t]he time for toleration has come to an end," 479 U.S. at 323 (*quoting United States v. Johnson*, 457 U.S. 537, 555-56 n.16 (1982)), the Court concluded that generally new rules for the conduct of criminal prosecutions will be applied retroactively to all pending or non-final cases even if they constitute a "clear break" with the past. 479 U.S. at 328. *See* Tribe, *supra*, at 31 n.26.

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[27] After this Court's decision in *Beam*, the *Harper* case and two other cases were vacated and remanded for further action by the State courts. *Harper v. Virginia Department of Revenue*, 111 S. Ct. 2883 (1991); *Bass v. South Carolina*, 111 S. Ct. 2881 (1991); *Norwest Bank Duluth v. James*, 111 S. Ct. 2881 (1991) (involving retroactive application of *Memphis Bank*). In all three cases, the courts refused to order refunds of the unconstitutionally collected taxes. *Harper*, App. A at 5a; *Bass v. South Carolina*, 414 S.E.2d 110, 115 (S.C. 1992), *petition for cert. pending*, 60 U.S.L.W. 3755 (U.S. April 24, 1992) (No. 91-1697); *Cambridge State Bank v. James*, 480 N.W.2d 647, 652 (Minn. 1992), *petition for cert. pending sub nom., Norwest Bank Duluth v. James*, 61 U.S.L.W. 3001 (U.S. July 7, 1992) (No. 91-2047).

Although cases addressing the validity of discriminatory state tax statutes do not involve considerations of the same magnitude as those presented in criminal procedure cases, such cases do implicate a constitutional right—an interstate business's right under the Commerce Clause and related provisions to be free from undue state-imposed burdens. They clearly involve rights different from, and indeed more significant than, the statute of limitations issue presented in *Chevron Oil*. Thus, in considering whether the *Chevron Oil* test should be supplanted by an even more stringent standard in all constitutional cases, the Court should give full weight to the type of interest involved. In criminal cases—where a liberty interest is at stake—the Court has already insisted on full retroactivity. Where the Commerce Clause or related Due Process or Equal Protection rights of taxpayers are implicated—or where, as here, the Supremacy Clause is involved and the litigant is not the United States but ancillary beneficiaries—a vivified *Chevron Oil* standard should permit prospective-only treatment only in rare cases. Hence, unlike the other civil cases in which the retroactivity issue has been considered, the unsuccessful litigant in a discriminatory state tax case—the party who seeks to have the finding of unconstitutionality applied on a prospective-only basis (the State)—is the progenitor of the proscribed (unconstitutional) action.

Because the States have it within their power to enact constitutional tax statutes, they should be held to a higher standard in obtaining exceptions to the general rule of retroactivity. States should ordinarily not be permitted to reap the benefits of discriminatory taxation while impairing the constitutional rights of taxpayers. The States' checkered history in enacting, collecting, and refusing to refund unconstitutional taxes only underscores this conclusion.

Too frequently, the States seem unable to abide by the rules and to face up to the consequences of their actions.

Like the person who continually promises to reform but repeatedly fails, the word of the States should no longer be considered sufficient: they should be judged by their actions, and their actions should be found wanting. It is time for judicial intervention, for the Constitution to prevail over the States' protestations of good faith. As the Court so forcefully proclaimed in *Griffith v. Kentucky*: "The time for toleration has come to an end." 479 U.S. at 323.

CONCLUSION

For the foregoing reasons, the Court should clarify the standard to be used in determining whether its decisions should be given prospective-only effect.

Respectfully submitted,

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In the
Supreme Court of the United States
October Term, 1992

HENRY HARPER, et al.,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

On Writ of Certiorari To
The Supreme Court of Virginia

BRIEF OF THE STATE OF UTAH AND THE STATES OF ALABAMA, ALASKA, CALIFORNIA, CONNECTICUT,

(Continued on the inside cover)

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*The South Carolina Tax Commission is joining in its capacity as the taxing authority in South Carolina.

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INTEREST OF AMICI CURIAE

Amici include states[1] that could be liable for refund claims depending on whether the rule announced in Davis v. Michigan Dep't of Treasury, 489 U.S. 803 (1989) ("Davis") is applied retroactively,[2] states that have resolved Davis refund claims under state law,[3] states that do not have statutes subject to challenge under Davis,[4] and states that do not tax individual income but depend on other tax revenues.[5] As governments providing a myriad of programs and services essential to their citizens, amici must be able to forecast and budget limited revenues with the confidence that taxes collected and spent under longstanding, presumptively valid tax statutes need not be refunded if such statutes are later invalidated by an unexpected and unforeseeable court decision. Because a state's ability to do so is directly affected by the rules governing the retroactive application of

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[1] Amici also include the Territories of American Samoa and the United States Virgin Islands, the Commonwealth of Puerto Rico, and the District of Columbia. All amici are referred to collectively as "states."

[2] Alabama, Iowa, Kentucky, Mississippi, Montana, New York, Oklahoma, South Carolina, Utah, and Wisconsin.

[3] See e.g., New Mexico and Oregon.

[4] Alaska, the Territory of American Samoa, California, the Commonwealth of Puerto Rico, Connecticut, Delaware, District of Columbia, Hawaii, Idaho, Illinois, Indiana, Maine, Maryland, Massachusetts, Minnesota, Nebraska, Nevada, New Hampshire, New Jersey, Ohio, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Vermont, Washington, and the Territory of the Virgin Islands.

[5] Alaska, Nevada, South Dakota, Texas, Washington, and Wyoming.

U.S. Supreme Court decisions involving state taxes, amici have a real and abiding interest in this case.

SUMMARY OF ARGUMENT

Unexpected and unforeseeable decisions of the Court with respect to state tax measures, if given fully retroactive effect, can upend the expectations of states and taxpayers regarding transactions justifiably regarded as settled. The three-part test set forth in Chevron Oil Co. v. Huson, 404 U.S. 97 (1971) ("Chevron Oil"), provides a fair, workable standard by which to determine the retroactivity of the Court's state tax decisions (a standard which recognizes stare decisis concerns underlying the retroactivity/prospectivity issue), considers the reliance interests of both the state and affected taxpayers, and balances those interests to reach an equitable result whenever a state tax statute is validated or invalidated on federal grounds.

The Chevron Oil test gives the Court the flexibility to take into account the economic impact of its law-changing decisions, and to avoid results that would only serve to punish the losing party for conduct that was altogether reasonable at the time. The significant fiscal consequences of Davis -- potential refund liabilities exceeding $1.841 billion -- highlight the continuing need for, and importance of, the Chevron Oil analysis.

Because a decision by the Court in a state tax case frequently implicates states and taxpayers other than the ones specifically before the Court, it is also important that non-party states or taxpayers affected by the Court's ruling be able to later raise the retroactivity issue, when the issue was

not raised or briefed by the parties, and the Court's decision itself does not explicitly dispose of the issue. The petitioners' suggestion that the question is decided sub silentio, if the Court does not expressly reserve the issue, should be rejected.

ARGUMENT

I.

The Unique Problems Associated with Retroactivity in State Tax Cases Compel Continued Application of the Chevron Oil Test.

The Court has long recognized the essential role that taxes play for states and their citizens. See e.g. Springer v. United States, 102 U.S. 586, 594 (1880) ("The prompt payment of taxes is always important to the public welfare. It may be vital to the existence of [the] government"); Dows v. Chicago, 11 Wall. 108, 110 (1871) ("It is upon taxation that the several States chiefly rely to obtain the means to carry on their respective governments."). The programs that state taxes support affect all the citizens of the state, and often involve services that could not realistically be furnished other than by the government, or services on which the program beneficiaries rely for their most basic needs. For these reasons, and because the result in a Supreme Court case challenging a state tax statute on federal grounds can reverberate far beyond the parties before the Court, Supreme Court decisions concerning the states' taxing power may potentially affect every individual and business in the nation.

The instant case dramatically illustrates the effect that such a Supreme Court decision can have. The Court's ruling three years ago in Davis, invalidated a portion of Michigan's income tax scheme on intergovernmental tax immunity grounds, and prompted litigation in 22 other states with similar tax provisions. The aftermath of Davis points out the continuing need for a clear and fair standard for determining when a Supreme Court decision invalidating a state tax statute will be applied retroactively. The Chevron Oil standard takes into account the special nature of state taxes and the tremendous, far-reaching impact of such a decision.

While the Court has the responsibility to see that statutes enacted by state legislatures comply with applicable federal constitutional principles, it has expressed a heightened regard for the unique importance of state taxes in general and the standards by which such taxes are measured. In cases involving Equal Protection issues, states are given great leeway in making classifications and drawing lines within tax statutes. Lehnhausen v. Lakeshore Auto Parts Co., 410 U.S. 356, 359 (1973). Where a classification is not "palpably arbitrary" or does not create "invidious" discrimination between persons similarly situated, there is no constitutional violation. Allied Stores of Ohio v. Bowers, 358 U.S. 522, 530 (1959). "Under [this] standard a statute will be sustained if the legislature could have reasonably concluded that the challenged classification would promote a legitimate state purpose." Exxon Corp. v. Eagerton, 462 U.S. 176, 196 (1983).

States are also given greater latitude in collecting taxes than Due Process would normally permit. "[I]t is well established that a State need not provide predeprivation process for the exaction of taxes." McKesson Corp. v.

Division of Alcoholic Beverages and Tobacco, 496 U.S. 18, 37 (1990). Rather, the seizure of property for the collection of taxes constitutes one of those "extraordinary situations" justifying postponement of notice and hearing until after the property has been seized. The deference accorded to state tax procedures is a recognition of the critical importance of state taxes to all state government functions. Congress has expressly required the same policy of deference in the Tax Injunction Act, 28 U.S.C. § 1341. Rosewell v. LaSalle National Bank, 450 U.S. 503 (1981). The Court, in determining the retroactive effect of an unanticipated holding that a state tax violates the Constitution, should have no less regard for the vital and vulnerable nature of state tax systems.

The test for determining retroactivity in this context should take into account the reasonable reliance interests and settled expectations of state governments, which must enact and administer taxing statutes in constitutional waters whose channels are often not clearly marked. The doctrine of intergovernmental tax immunity, upon which Davis and this case are based, has been described as ambiguous and as one of the "most esoteric of constitutional philosophies." Bohn v. Waddell, 790 P.2d 772, 784 (Ariz. Tax Ct. 1990); Swanson v. Powers, 937 F.2d 965, 968 (4th Cir. 1991), cert. denied, __ U.S. __, 112 S. Ct. 871 (1992).[6] Consequently, state legislatures and tax officials, acting in good faith, will sometimes miss what later emerges as the constitutional

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[6] Compare Justice Scalia's comment with regard to the negative commerce clause: "[T]he practical results we have educed...form not a rock but a 'quagmire'." Tyler Pipe Industries v. Dep't of Revenue, 483 U.S. 232, 259 (1987) (Scalia, J., concurring in part and dissenting in part) (quoting Northwestern States Portland Cement Co. v. Minnesota, 358 U.S. 450, 458 (1959)).

mark. The price that the state and its citizens must pay for the failure to foresee new constitutional developments should not necessarily be years of retroactive liability for taxes already collected and spent.

The problem becomes even more acute when state tax statutes in place for years are assailed as violative of constitutional principles that have evolved over time. One practical gauge of a statute's continued validity is the absence of serious challenges. Therefore, the Court's retroactivity standard should take into account whether a decision "disrupts a practice long accepted and widely relied upon." Milton v. Wainright, 407 U.S. 371, 381-82 n. 2 (1972) (Stewart, J., dissenting), cited with approval in United States v. Johnson, 457 U.S. 537, 552 (1982).

The Court has recently reaffirmed its concern for the effect which its state tax decisions can have on settled expectations. In Quill Corp. v. North Dakota, 504 U.S. __, 112 S. Ct. 1904 (1992), the Court noted that "the Bellas Hess rule has engendered substantial reliance and has become part of the basic framework of a sizeable industry. The 'interest in stability and orderly development of law' that undergirds the doctrine of stare decisis . . . therefore counsels adherence to settled precedent." Id. at 1916 (quoting Runyon v. McCrary, 427 U.S. 160, 190-191 (1976) (Stevens, J. concurring)). As noted in American Trucking Ass'ns v. Smith, 110 S. Ct. 2323, 2341 (1990) (plurality) (quoting United States v. Estate of Donnelly, 397 U.S. 286, 295 (1970) (Harlan, J. concurring):

> In those relatively rare circumstances where established precedent is overruled, the doctrine of non-retroactivity allows a court to adhere to

> past precedent in a limited number of cases, in order to avoid "jolting the expectations of parties to a transaction." . . . As Justice Cardozo discerned, prospective overruling allows courts to respect the principle of *stare decisis* even when they are impelled to change the law in light of new understanding.

Amici submit that the three-part test set forth in Chevron Oil v. Huson, 404 U.S. 97 (1971), provides a reasonable, workable standard to determine the retroactivity of the Court's state tax decisions.[7] The Chevron Oil analysis recognizes stare decisis concerns, considers the reliance interests of both the state and affected taxpayers, and balances those interests to reach an equitable result involving either the validation or invalidation of a state tax statute.

In a large majority of cases, the Court will assess the legality of a state tax on the basis of established Supreme Court precedent, and the Court's decision -- while contributing to the Court's jurisprudence -- will not take the Court in an entirely new direction. If the challenged tax is ruled constitutional based on established precedent, it is

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[7] In Chevron Oil, supra, the Supreme Court set forth three factors to be considered in determining whether a judicial ruling should operate prospectively only. A decision will operate prospectively only:

(1) if it establishes a new principle of law by overruling clear past precedent or by deciding an issue of first impression whose resolution was not clearly foreshadowed;

(2) if prospective only application will not retard the operation of the rule in question; and

(3) if retroactive application would result in inequity, injustice or hardship. Chevron Oil, 404 U.S. at 106-107.

appropriate to give the decision full retroactive effect, and the Chevron Oil analysis would so provide. States, if they are to plan and operate effectively, must be able to rely on revenues collected under statutes that satisfy existing Supreme Court precedent, and taxpayers should be expected to treat such enactments as valid until struck down.

The Chevron Oil analysis also reaches a fair result when a state tax statute is held unconstitutional based on existing Supreme Court precedent. Under such circumstances, the state could not justifiably have relied on the revenues generated by its enactment, would have no settled expectations entitled to deference, and could not reasonably complain when the Court's ruling is given retroactive effect. For the operation of Chevron Oil under these facts, see Ashland Oil, Inc. v. Caryl, 497 U.S. 916 (1990).

If all Supreme Court decisions were automatically given retroactive effect, however, unacceptably harsh consequences could follow when the Court overruled clear past precedent in validating or invalidating a state tax statute on federal grounds. This particularly is true as to challenges that may be brought after a new decision is announced. If a statute enacted in good faith reliance on clear Supreme Court precedent is later held invalid, prospective-only application of the new rule will sufficiently vindicate the successful taxpayer, who will no longer be subject to the offending levy, without upending the state's reasonable assumptions regarding matters thought to be complete, or threatening undue interference with the state's ability to fund essential government services.

By the same token, taxpayers have legitimate reliance interests that should not be ignored when determining the retroactive effect of a Supreme Court ruling. If the Court overrules clear precedent under which a state tax statute would have been unconstitutional, the taxpayer's expectations will be upset by a fully retroactive application of the holding. Such an application could permit the state to impose a wholly-unanticipated back-liability on individuals or businesses who had reasonably assumed all their taxes had been fully paid. While taxpayers in this situation may be protected in part by other constitutional principles which limit the state's ability to assess taxes retroactively based on events occurring in prior years, see, e.g., Welch v. Henry, 305 U.S. 134, 147 (1938) ("retroactive application [may be] so harsh and oppressive as to transgress [Due Process]"), such restraints are themselves based on the principle which the Chevron Oil test is intended fully to vindicate: under certain circumstances it is fundamentally unfair to revisit transactions justifiably regarded as finished.

The first prong of the Chevron Oil test directs the Court to determine whether the decision establishes a new principle of law "by overruling clear past precedent on which litigants may have relied." Chevron Oil, 404 U.S. at 106. This analysis does not require prospectivity in all cases. Rather, the overruled precedent must have been "clear," so that the losing party might reasonably have "relied" on it. The Chevron Oil test allows the Court to view a constitutional issue in its full historical perspective, and to consider whether the overruled decision may have been narrowed or questioned over the years to the extent that it retained little vitality.

The Chevron Oil analysis also accommodates the situation in which the Court first announces a new rule of law. The number and variety of tax issues confronting state officials and taxpayers are staggering, and the Court will inevitably be faced with circumstances in which no applicable precedent exists. In times of shrinking economies and declining tax bases, states should not be asked to forsake possible revenue sources simply because there is no such precedent by which to prejudge the validity of a proposed tax measure. By the same token, a taxpayer cannot argue that he justifiably relied on the unconstitutionality of a statute when there was no Supreme Court precedent clearly foreshadowing that result. If the taxpayer succeeds in a challenge, and the Court adopts a new legal rule, the taxpayer will still receive the rule's future benefit.

Once a decision establishes "a new principle of law," the Chevron Oil test provides built-in flexibility that takes into account equitable considerations. The Court must weigh "the inequity imposed by retroactive application" and determine if retroactive application "could produce substantial inequitable results." Chevron Oil, 404 U.S. at 106-107. There would be little reason to depart from the normal rule of retroactivity, notwithstanding an unexpected and unforeseeable holding, where the liability for back taxes or refunds resulting from retroactive application would be insignificant. The instant case presents quite the opposite situation, however, one in which the effect of retroactive application could be devastating to those states that were understandably surprised by the new rule of law announced in Davis.

Nearly ten years ago Justice Powell, writing for five Justices in Arizona Governing Committee for Tax Deferred

Annuity and Compensation Plans v. Norris, 463 U.S. 1073 (1983), concluded that the imposition on the State of Arizona of retroactive monetary liability potentially amounting to hundreds of millions of dollars would be inappropriate even though the state had violated Title VII in its administration of a state retirement plan. The Court explained that "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial financial deficits. Income, excise and property taxes are being increased." Id. at 1106-07. Because the illegality of Arizona's conduct had not been settled until the Norris decision itself, the Court saw "no justification . . . to impose this magnitude of burden retroactively on the public." Id. at 1107. The circumstances in the present case are even more compelling than those in Norris.

II.

The Potential Fiscal Impact of Retroactive Application of Davis is Enormous.

The total amount at stake among the sixteen states still dealing with Davis-related issues is over $1.841 billion. The chart below sets out the potential refund liability under statutes of limitations argued by retirees.

Projected Refund Liability Under State Statute of Limitations Period[8]

Alabama	$ 20 million
Arizona	339 million[9]
Arkansas	45 million
Georgia	100 million
Iowa	41 million
Kansas	95 million
Kentucky	74 million
Mississippi	35 million
Montana	20 million
New York	55 million

[8] Unless otherwise noted, all amounts are estimates of the potential liability for full refund of tax principal and accrued interest. The information contained in this chart was provided by each state's Department of Revenue or Taxation through its legal counsel in response to a telephone survey. See also, Appendix A, Brief for Respondent.

[9] The Arizona Tax Court has issued a refund order using a partial refund formula whereby the state's liability is substantially less than this figure. This order has been appealed by both parties.

North Carolina	140 million[10]
Oklahoma	20 million[11]
South Carolina	200 million
Utah	120 million
Virginia	467 million
Wisconsin	70 million
TOTAL	$1.841 billion

The retroactive liability threatened by Davis comes at a time when "many states struggle with the biggest fiscal crisis to hit them in a decade."[12] State revenue growth nationally slowed from a pre-recession average of 9.2% annually to 2.5 and 2.0 percent, respectively, during 1990 and 1991.[13] Corporate income tax collections dropped by

[10] Amount alleged by federal retirees to be at issue in presently pending class action litigation.

[11] Estimated tax liability exclusive of any interest.

[12] Obstacle to Recovery: States' Fiscal Squeeze, Wall St. J. (June 17, 1991) at A1.

[13] Bureau of the Census, U.S. Dep't of Commerce, Quarterly Summary of Federal, State, and Local Tax Revenue 5 (April-June 1991).

roughly 12% in 1990 alone.[14] The states' sales tax bases eroded[15] as household spending on durable and non-durable goods declined.[16] During 1987, 1988, and 1989, total state and local government expenditures exceeded revenues by 2.7, 3.1, and 3.1 percent respectively, taking into account everything other than contributions to or benefits paid from "social insurance funds" such as state and local retirement plans, which are properly regarded as funds not generally available to the government.[17] With the onset of the recession, the situation worsened: in 1990 and 1991, such expenditures -- including the costs of services increasingly strained by the effects of the economic downturn, such as greater unemployment -- exceeded revenues by roughly 5%.[18] As a consequence, by the 1991 fiscal year, state reserves, so-called "rainy day" funds to protect against revenue shortfalls and unexpected expenses, had fallen to an

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[14] Id.

[15] Id.

[16] Bureau of Economic Analysis, U.S. Dep't of Commerce, Personal Consumption by Major Type of Product, Survey of Current Business 65 (July 1992).

[17] Sullivan, D., Bureau of Economic Analysis, U.S. Dep't of Commerce, State and Local Government Fiscal Position in 1991, Survey of Current Business 36-41 (March 1992). In 1987, for example, the $14.7 billion deficit referenced equals 2.7 percent of the difference between total receipts of $594.3 billion and $49.2 billion in social insurance contributions.

[18] Id.

average of 0.8% of expenditures,[19] an amount adequate only to offset for 75 days the effects of inflation on a state's purchasing power. Massive state budget shortfalls, attributable to declining tax revenues and increased mandatory state spending on federal entitlement programs, are forcing states to cut services, lay off employees, and raise taxes.[20] New York, for example, which faces a $55 million refund liability as a result of Davis, has proposed to eliminate a $938 million budget deficit by cutting $1.2 billion in welfare programs, eliminating 6,200 state jobs, and raising levies on hospitals and nursing homes.[21]

Montana is yet another Davis state dealing with a severe budget crisis. Montana is a state with one of the highest poverty rates and the sixth lowest median household income in the nation. It recently convened its second Special Legislative Session in two years to address a $140 million budget deficit. This deficit represents roughly $175 for every man, woman, and child in the state,[22] or $700 for a family of four. Among the legislative proposals considered to ease the budget crunch were the adoption (for the first time) of a 4% state sales tax, the implementation of an unpaid furlough

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[19] National Governors' Association/National Association of State Budget Officers, Fiscal Survey of the States 25 (April 1992).

[20] Supra, note 12. See also State Tax Revenue Growth is Hurt by Slow Economy, Wall St. J. (Nov. 14, 1990) at A10.

[21] Cuomo's New York Budget to Cut Welfare, Wall St. J. (Jan. 22, 1992) at A16.

[22] According to the 1990 census, Montana's population was less than 800,000.

program for state employees, a reduction of state education spending by eight to ten percent, and a 7% annual surtax on all general fund tax revenue sources. While Montana's potential refund liability under Davis is only $20 million, this equates to an additional $100 in taxes for the average family of four in the state.

If refunds are required in Davis litigation, the hardest hit will be among this country's poorest and least educated. The 1990 census found that 13.1% of the U.S. population lived below the poverty level, and 75.2% had at least a high school education. Of the Davis states, four are located in the South Central region, the poorest in the nation. Alabama has a poverty rate of 18.3%, and a high school graduation rate of only 66.9%. In Arkansas, 19.1% live in poverty, while only 66.3% have their diploma. In Kentucky, the figures are 19.0% and 64.6%, respectively. Over a quarter of Mississippi's population (25.2%) lives in poverty, and only 64.3% have graduated from high school. These states already are dealing with budget crises: Alabama has cut agency budgets 5% across the board, Arkansas has been forced to reduce education spending, and Kentucky is taking steps to eliminate a $200 million budget deficit for the 1991 biennium. At the same time, the combined potential refund liabilities under Davis, of Alabama, Arkansas, Kentucky, and Mississippi, exceed $173 million.

Finally, revenue collections in the Respondent state, Virginia, have not only failed to keep pace with an inflation rate of 5.1%, but actually declined in 1991 (from $5.494 billion to $5.471 billion). This revenue loss, coupled with the effects of inflation and an 18.4% increase in federally-mandated Medicaid expenditures, has required the reduction of state agency budgets on an average of 25% below 1990

funding levels. Virginia's potential liability arising from Davis now exceeds $467 million, an amount that, if it had to be refunded, would need to be recouped through further cuts in services or employment, an increase in the state's sales tax rate from 4.5% to 5.5%, or similar measures adversely affecting all the citizens of that state.

Contrary to petitioners' view, state government is not merely a deep pocket from which to extract painlessly the tremendous sums involved in a case like this. The burden of a retroactive application of an unexpected and unforeseeable Supreme Court decision invalidating a state tax statute "will fall not on some corrupt state government, but ultimately on the blameless and unexpecting citizens of [the state] in the form of higher taxes and reduced benefits." James B. Beam Distilling Co. v. Georgia, 111 S. Ct. 2439, 2456 (1991) ("Beam") (O'Connor, J., dissenting). The Chevron Oil test gives the Court the flexibility to take into account the economic impact of its law-changing decisions, and to avoid results that would only serve to punish the losing party for conduct that was altogether reasonable at the time.

III.

Resolution of the Retroactivity Issue Should Be Made Explicitly and with an Opportunity for Interested Parties to Be Heard.

Because retroactive application of the Court's tax decisions can have such far-reaching ramifications, a non-party state or taxpayer affected by the decision should be able to raise the retroactivity issue later, whenever the issue was not raised or briefed at all in the earlier case and the Court's

decision itself does not explicitly dispose of the question. On page 9 of their brief, petitioners state that "Beam . . . requires that every . . . court apply Davis' substantive holding to the parties before them." Petitioners argue that Beam mandates retroactive application of a decision by the Court -- and mandates such application as to everyone affected thereby, not simply the actual parties before the Court -- if the substantive decision itself does not specifically reserve the issue or hold that the ruling will operate prospectively only. Amici in support of the petitioners state that "when this Court chooses to reserve judgment on the retroactive or prospective application of a rule-changing decision, it has had no difficulty expressing that determination in the rule-changing decision itself."[23] Yet at the time Davis was decided, there was no hint from any of the Court's prior opinions that silence might be read to have the impact that the petitioners claim for it here. The inequity of applying the petitioners' rule to the case at hand is apparent. While no majority line of reasoning emerges from Beam, one point is clear: the end result stems solely from the fact that the Court chose to give the litigants in Bacchus Imports, Ltd. v. Dias, 468 U.S. 263 (1984), the retroactive benefit of the new rule established by that case, because the Court there had in fact decided in favor of retroactivity. See Beam, 111 S. Ct. at 2445 n.2 (Souter, J., plurality opinion). In Davis, by contrast, the State of Michigan had previously agreed to pay the taxpayer a refund if Michigan's statute was found to violate federal law, and the retroactive application of the Court's decision to Mr. Davis was not at issue. In short, the present case is unlike Beam because Davis is unlike Bacchus.

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[23] Brief Amici Curiae for Designated Federal Retirees in Kansas, et al., page 7 n.3.

Even if applied only to future cases, the rule proposed by the petitioners presents problems. Retroactivity may not be raised by the parties because the question is irrelevant under the tax statutes of the particular state. See, e.g., Hackman v. Missouri, 771 S.W.2d 77, 81 (Mo. 1989), cert. denied, 493 U.S. 1019 (1990) ("[W]e hold that by its adoption of Section 143.801, the State of Missouri has consented to a refund of any overpayment . . . of income tax . . . . Having so concluded, there is no need to consider whether Davis should be applied retroactively or only prospectively . . . ."). See generally McKesson Corp. v. Division of Alcoholic Beverages and Tobacco, 496 U.S. 18, 52 n.36 (1990) ("The State is free, of course, to provide broader relief as a matter of state law than is required by the Federal Constitution.")

A party may make a poor tactical decision and fail to advance a valid claim that any adverse ruling should be given prospective effect only. The viability of such a claim may be apparent only after the Court's substantive decision has been carefully analyzed. According to petitioners, the Court must expressly determine, in the substantive ruling itself, either that the decision should be applied prospectively only or that such an argument has sufficient merit to be reserved; otherwise, the decision applies retroactively to everyone. Without the benefit of briefs on the question, however, the Court may not be in a position to appreciate the impact of its ruling on transactions and events occurring before the date of decision, or the extent to which the Court's ruling may represent an unexpected departure from prior law. "It is . . . often difficult to determine when a case announces a new rule," Teague v. Lane, 489 U.S. 288, 301 (1989) (plurality), as the conflicting decisions of the courts that have grappled with Davis make clear.

While the Court's sua sponte 'consideration of retroactivity may be "far from novel," id. at 300, the Court should not feel obligated to deal with such a potentially important matter at the point of initial decision, at least where, as in Davis, doing so would not affect the actual outcome of the case at hand. Even a decision to expressly reserve the retroactivity issue, or to invite amicus briefs on the issue, involves a threshold determination regarding the validity of an argument in favor of prospective-only application. When the Court chooses simply to make no comment whatsoever, that should not prematurely preclude other affected states or taxpayers from raising, briefing, and fully arguing the point at some other time.

CONCLUSION

For the reasons discussed above, amici respectfully submit that the Court should clearly recognize Chevron Oil as the test by which retroactivity will be determined in a case like this, apply that test as urged by the State of Virginia to the Court's decision in Davis, and affirm the decision of the Virginia Supreme Court below.

Respectfully submitted,

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Supreme Court of the United States

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HENRY HARPER, et al.,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

On Writ Of Certiorari To
The Supreme Court Of Virginia

BRIEF OF THE STATE OF GEORGIA AS AMICUS CURIAE IN SUPPORT OF RESPONDENT

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INTEREST OF AMICUS CURIAE

The State of Georgia, as one of 16 states still involved in litigation resulting from *Davis v. Michigan Dep't of Treasury*, 489 U.S. 803 (1989), has both an immediate and long-term interest in the rules governing retroactive/prospective application of U.S. Supreme Court decisions invalidating state tax statutes.

SUMMARY OF ARGUMENT

The amicus brief filed by James B. Beam Distilling Company ("Beam") mischaracterizes the State of Georgia's position on remand following this Court's ruling in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991) ("*Beam*"), concerns matters which this Court in *Beam* specifically reserved for resolution by the lower courts, and is irrelevant to the instant case. Beam's contentions should not be allowed to confuse the important issues presented here. Rather, the Court should recognize *Chevron Oil v. Huson*, 404 U.S. 97 (1971) as setting out the test by which retroactivity will be determined in this case, and affirm the Virginia Supreme Court.

ARGUMENT

The instant case presents this Court with an opportunity to set forth unequivocally a retroactivity standard that recognizes the reasonable reliance interests and settled expectations of state governments and that takes into account the special nature of state taxes. Amicus agrees

with Respondent State of Virginia that the *Chevron Oil* analysis is a fair, reasonable, and workable test for this case. Instead of burdening the Court with yet another brief to this effect, the State of Georgia would have preferred simply to join with other amici states which have articulated in greater detail their support for the *Chevron Oil* test and the decision of the Virginia Supreme Court below. However, James B. Beam Distilling Company has filed an amicus brief in support of the petitioners to complain of alleged "conduct of the State of Georgia since the date this Court ruled in *Beam*," Brief of Amicus Beam, page 1. The State of Georgia cannot allow Beam's allegations to go unanswered, for they are unwarranted and baseless, are inappropriately asserted in this proceeding, and should not influence the Court's consideration of the important issues actually before the Court.

Regrettably, Beam's participation in this case appears to be an effort to improperly gain an advantage in Beam's litigation with the State of Georgia, now on remand to the trial court. Mischaracterizing the State's position on remand as "frivolous" and "procedural gamesmanship," Brief of Amicus Beam, page 5, Beam asserts that "the only remaining task of the court [below] is to enter judgment for Beam," Brief of Amicus Beam, page 10, and the company essentially urges the Court to say so here. Beam's assertion that this Court's earlier opinion deprives the State of Georgia of the opportunity to argue remedial issues on remand is groundless. In the *Beam* decision, the Court expressly declined

> [to] speculate about the remedy that may be appropriate . . . ; remedial issues were neither considered below nor argued to this Court, save for an effort by petitioner to buttress its claim by our decision last Term in *McKesson*. As we have observed repeatedly, federal "issues of remedy . . . may well be intertwined with, or their consideration obviated by, issues of state law." *Bacchus*, 468 U.S. at 277. Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal.

111 S. Ct. at 2448. After remand of the case to the Georgia Supreme Court, the case was remanded to the trial court. Beam immediately initiated discovery to develop a record concerning the remedial issues left open by the Court's ruling, and, after discovery by both parties, each moved for summary judgment. These motions are now pending, and involve such issues as the applicability of various procedural bars under state law, construction of state remedial statutes, whether Beam (if entitled to any recovery) could recover more than 50% of its payments, and other purely remedial issues. While Beam may disagree with the State's position on some of the remedial issues, counsel for Beam acknowledged before the trial court that the State's contentions are being asserted in good faith. Further, the arguments and issues before the trial court constitute matters which the Court specifically reserved for resolution on remand, and which should be disposed of by the courts below before any party, including Beam, attempts to seek this Court's review again.

In the matter which is truly at hand, the State of Georgia fully supports Respondent State of Virginia.

Amicus agrees that the three-part test set out in *Chevron Oil v. Huson*, 404 U.S. 97 (1971) should be the test by which the Court determines retroactivity in the instant case, and that the Court's holding in *Davis*, when measured against the *Chevron Oil* standard, should be given prospective-only effect. Beam's effort to catapult back into this Court serves only to muddy the waters, and Beam's arguments are entitled to no serious consideration.

CONCLUSION

The decision of the Virginia Supreme Court should be affirmed.

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No. 91-794

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IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1992

Henry Harper, *et al.*, *Petitioners*

v.

Virginia Department of Taxation, *Respondent*

ON WRIT OF CERTIORARI TO THE
SUPREME COURT OF VIRGINIA

AMICUS CURIAE BRIEF
BY THE STATE OF ARKANSAS
IN SUPPORT OF RESPONDENT

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No. 91-794

IN THE
SUPREME COURT OF THE UNITED STATES

October Term, 1992

HENRY HARPER, *et al., Petitioners*

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent

AMICUS BRIEF BY THE STATE OF ARKANSAS IN SUPPORT OF RESPONDENT

INTEREST OF AMICUS CURIAE

Pending before this Court on a petition for certiorari is an Arkansas case, *Pledger v. Bosnick*, 306 Ark. 45, 811 S.W.2d 286 (1991), *pet. for cert. pending* No. 91-375, ("Pledger") the outcome of which, if *Davis v. Michigan Department of Treasury*, 489 U.S. 803, (1989) ("Davis") is applied retroactively, will have a devastating effect upon the citizens of the State of Arkansas.

Two basic issues remain in *Pledger* after this Court's decision on the military retiree question in *Barker v. Kansas*, 503 U.S. ___, 118 L.Ed.2d 243, 112 S.Ct. 1619 (1992). If the decision here is to apply *Davis* prospectively only, consideration of the issue of whether the doctrine of intergovernmental tax immunity is to be extended to retirees who had been employed with other states and their political subdivisions will not be necessary.

If *Davis* is applied retroactively and the doctrine of

intergovernmental immunity is extended, Arkansas could be required to refund in excess of $50 million. The potential refund as of May 15, 1992 was $44.7 million, with a monthly interest accrual of $261,587.00.

As will be discussed further *infra*, the economic realities of this potential refund situation will adversely affect current and future generations of Arkansans.

SUMMARY OF ARGUMENT

Amicus urge the affirmance of the decision of the Virginia Supreme Court to apply this Court's *Davis* decision nonretroactively. *Davis* established a rule which diverged from prior interpretation of federal law. Retroactive application of this decision will frustrate the purposes of intergovernmental tax immunity and will work a substantial hardship on Respondent and other states including Amicus. Nonretroactive application will provide Petitioners relief that is constitutionally sufficient.

ARGUMENT

THE VIRGINIA SUPREME COURT CORRECTLY CONCLUDED THAT *DAVIS V. MICHIGAN* SHOULD NOT APPLY RETROACTIVELY.

I. When decisions are not consistent with prior law and retroactive application is not presumed, retrospective application must be closely scrutinized.

Retroactive application of a decision of this Court is usually a given. *See James B. Beam Distilling Co. v. Georgia*, 501 U.S. ___, 115 L.Ed.2d 481, 487 (1991). From a jurisprudential standpoint, automatic retroactivity advances the need for finality. *Id.* at ___, 115 L.Ed.2d at 492-93. Indeed, it is often implicit, yet obvious, that a decision of this Court is binding on all cases under review at the time of decision and in the future. *Id.* at ___, 115 L.Ed.2d at 490.

Nevertheless, the Constitution contemplates, and this Court has determined, that retroactivity is not an absolute. *Id.* at ___, 115 L.Ed.2d at 494 (White, J. concurring); *American Trucking Ass'ns v. Smith*, 495 U.S. ___, 110 L.Ed.2d 148, 168 (1990). Although this issue is rarely questioned in the civil context, there are situations involving a break from prior precedent or a decisional trend upon which third parties reasonably relied. The question of retroactive application is present because either the parties to the original action did not litigate the retroactivity issue or the Court did not explicitly or implicitly state that the decision applied retroactively. *Id.* In other words, the new rule is unexpected and could seriously affect either a party or a nonparty in retrospect. The result of retroactive application under these circumstances is a legal obligation for acts that were, at their occurrence, valid.

When retroactivity is not discussed, a question of choice of law arises or remains unanswered. It involves a choice between retroactivity and nonretroactivity which must be decided before a state can fashion a remedy consistent with Due Process and state law. *See Beam* at ___ , 115 L.Ed.2d at 487-88; *Smith* at ___ , 110 L.Ed.2d at 158-59; *McKesson v. Division of Alcoholic Beverages and Tobacco*, 495 U.S. ___ , 110 L.Ed.2d 17, 45 (1990).

It is also important, based on Petitioner's argument, to note what the federal question is not. It is not a question of remedy. For "state courts have the initial duty upon remand of crafting appropriate relief in accord with both federal and state law." *McKesson* at ___ , 110 L.Ed.2d at 33 n.16. Nor is it a question of a right to a refund. For this Court has stated that retroactive application and due process in tax cases may require a refund subject to state procedural bars. *Id.* at ___ , 110 L.Ed.2d at 37-39. While retroactive application in a tax case may result in a refund, it does not follow that because a refund is conceded retroactive application has been decided or is implied. The point is that before Due Process issues are considered, a determination must be made of the distinct issue of retroactivity, the only question before this Court in the present case.

A pertinent example of the nonretroactivity question is the situation encountered by a state taxing authority relying on past precedent. For instance, in *Smith*, Arkansas relied on a line of cases that indicated its HUE tax was valid. A similar tax was unexpectedly defeated in *American Trucking Ass'ns v. Scheiner*, 483 U.S. 216 (1987). This Court determined that Arkansas should not be subject to *Scheiner* for taxes imposed prior to that decision. It also determined that sufficient protection of the taxpayers' commerce clause interests could

be accomplished by prospective relief. The only taxes subject to *Scheiner* were those in which the taxable event occurred after the case was decided. *Smith* at ___ , 110 L.Ed.2d at 173.

In the instant case, Amicus and Virginia both enacted taxes consistent with Federal law prior to *Davis*. The taxes were not enacted in ignorance of Federal law, but were instead based upon the body of law in this area that would lead to a different conclusion. *Davis* not only broke a trend, but also left the retroactivity issue open. Furthermore, the *Davis* opinion only said that Michigan had conceded a refund; it did not make a ruling on retroactivity.

In response to *Davis*, Respondent and Amicus removed the now unconstitutional provisions and inserted provisions that were nondiscriminatory by *Davis* standards. *See* 1989 Ark. Acts 27 (3d Ex. Sess.); 1989 Va. Acts c. 3 (Spec. Sess. II). When a state has attempted to follow federal law in good faith and retroactive application is not implicitly or explicitly discussed in the precedent-setting case, review of the choice of law between retroactive and prospective application must be made.

II. Based on the tests set forth in *Chevron Oil Co. v. Huson*, *Davis* should not be applied retroactively.

Once it is established that retroactivity may not be applicable, it is necessary to analyze the case under the tests enumerated in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) ("Chevron"). This narrow test is based upon three factors which properly define the limits of nonretroactivity.

A. *Chevron* Factor Number One

The first *Chevron* factor focuses on whether "new" law

was developed by the prior decision. Amicus does not wish to elaborate further on the argument submitted by Respondent, but acknowledges its complete agreement that the *Davis* decision created a "new" rule.

B. *Chevron* Factor Number Two

The second factor places the constitutional concept in historical perspective to promote a consistent body of law. As stated by the *Chevron* Court,

> In determining whether a decision should be given nonretroactive application, the Court must weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard its operation.

404 U.S. at 106-07.

To analyze the second factor in this case, intergovernmental tax immunity must be discussed. The *Davis* discussion of this concept is informative. While the majority points to the waiver of jurisdiction in 1939 by the Public Salary Tax Act and the concurrent development of the constitutional doctrine of intergovernmental tax immunity, the dissent focuses on prior interpretation of the Act and related acts which are pertinent here. 489 U.S. at 818-828 (Stevens, J.). The point of the dissent is that prior law indicates that Virginia's interpretation of the nondiscrimination provision was correct. This seems plausible in light of the winding road of interpretation that characterizes intergovernmental tax immunity doctrine. *See Id.* The uncertainty and prior decisions demonstrate how Virginia, like other states, attempted to comply with federal law. Only when the *Davis*

decision was rendered did a constitutional violation appear.

In *Davis*, this Court stated that intergovernmental tax immunity has as its goal "legitimate state taxation." 489 U.S. at ___ . A tax is not, however, legitimate because it is enacted by a state. The tax must also be nondiscriminatory. Virginia, like other states, followed the former interpretation in enacting and enforcing a constitutionally valid statute. When the law became unconstitutional, the Virginia Legislature, like the Arkansas General Assembly, moved with deliberate speed to remove the invalid provision. *See* 1989 Ark. Acts 27 (3d Ex. Sess.) (enacted Nov. 6, 1989). Like Virginia's, Arkansas' law applies to income tax years beginning with the year of the *Davis* decision. *Id.* Under the law at the time the taxable event occurred, the taxes were valid and at least appeared by reasonable interpretation to be nondiscriminatory.

Petitioners suggest that prospective application will inhibit intergovernmental tax immunity by encouraging states to adopt unconstitutional taxes. This conclusion is untrue for many reasons. First, state agencies are generally required by state law to uphold the Constitution of the United States. This requirement is not without meaning. Second, cases such as this occupy state resources that could be used for other purposes. In the interest of efficiency, states are encouraged to avoid lawsuits. Finally, the financial uncertainty created by the prospect of refunding millions of dollars already discourages enacting unconstitutional taxes. Most states don't have money to use on extra refunds and would prefer to be secure in the knowledge that taxes collected and used now will not have to be offset by tax dollars collected later. The myth of the greedy, overbearing government is historical and not applicable in modern situations. In this case, it is especially untrue.

The intergovernmental tax immunity doctrine will not be advanced by retroactive application of *Davis*. In addition, retroactive application, in balance, will subvert the purposes of intergovernmental tax immunity.

C. *Chevron* Factor Number Three

The third prong of the *Chevron* test involves equitable considerations. This Court has stated "[w]here equitable considerations of the Court produce substantial inequitable results if applied retroactively, there is ample basis for avoiding the injustice or hardship by a holding of non-retroactivity." 404 U.S. at 107. Equitable considerations have an appropriate and not insignificant role in the decision. *Smith* at ___ , 110 L.Ed.2d at 161-62. As Justice O'Connor stated in *Smith*:

> [T]he threshold determination whether a new decision should be applied retroactively is a crucial one, requiring a hard look at whether retroactive application would be unjust. At this initial stage, the question is not whether equitable considerations outweigh the obligation to provide relief . . . , but whether there is a constitutional obligation in the first place. *Id.* (citation omitted).

Prior to Act 683 of 1975, the first $6,000 of annuities received from any federal retirement system or any state, county, municipal or school district retirement system in the State of Arkansas was exempt from income tax. 1975 Ark. Acts 683. Act 683 expanded the $6,000 exemption to include annuities received by Arkansas residents from state, county, municipal and school district retirement systems in other states. Act 683 went one step further. It provided a total exemption from Arkansas' income tax of all annuities

received by retirees from the Arkansas Teachers Retirement System. This was intended as an incentive for Arkansas teachers, who historically have received smaller salaries than teachers in other states, to remain in the state and in their chosen profession.

In 1977, Act 793 made benefits received from a state named plan and from the Arkansas State Highway Retirement System fully tax exempt. 1977 Ark. Acts 793. The purpose was to encourage poorly compensated state employees to remain in state government.

It should be pointed out that the first $6,000 of compensation received by members of the armed services of the United States has been exempt from Arkansas income tax since 1943. In addition, the first $6,000 of retirement benefits for armed services retirees was exempt.

In *Streight v. Ragland*, 280 Ark. 206, 655 S.W.2d 459 (1983), the Arkansas Supreme Court upheld the constitutionality of state income tax exemptions on the retirement income of federal, state, county and municipal retirees. Six privately retired taxpayers sought to have their state income tax on a privately sourced retirement income declared an illegal exaction or the exemptions (both the $6,000 and 100 percent exemptions) declared unconstitutional under the equal protection clause. Applying the rational basis test, the Special Chancellor indicated that

> the legislature may have sought to encourage entry into public service by granting the challenged tax exemptions.

Id. at 464. The Special Justice pointed out that *Streight* did not question the fact that exemptions were given to federal civil

service and military retirees as well as state employees. In other words, why would the state grant exemptions to federal employees? No question was raised concerning the disparate treatment between federal employees ($6,000 exemption) and state employees (full exemption). No mention was made of the intergovernmental immunity doctrine.

Changes to the exemption statutes occurred again in 1985, 1987 and in 1989 (both prior and subsequent to the decision in *Davis*). In 1985, the $6,000 exemption was extended to include retirement benefits received from "any employment related retirement system, plan or program", i.e. the exemption now applied to private retirement plans (1985 Ark. Acts 486). (Although Arkansas prevailed in *Streight*, it did not act as the greedy, overbearing government as Petitioners suggest would happen.) Act 521 of 1987 provided that residents who received both military retirement pay and other retirement or disability benefits prior to January 1, 1985 are entitled to two $6,000 exemptions (1987 Ark. Acts 521). Again, military employees received an advantage over civilian employees. Act 512 of 1989 extended the deadline from retiring under the Teacher Retirement System for purposes of exemption from income tax from December 31, 1989 to July 1, 1990 (1989 Ark. Acts 512).

Davis was decided March 28, 1989, and the complaint in *Pledger* was filed March 31, 1989.

A special session of the Arkansas legislature was convened and on November 6, 1989, Governor Bill Clinton signed into law Act 27, which was applicable to all income years beginning on or after January 1, 1989. This Act discontinued the total tax exemption for Arkansas state retirement benefits, and gave a $6,000 exemption to all who received benefits from retirement plans.

Although after *Davis*, one might conclude that Arkansas law discriminated against federal retirees, the facts are that state retirees received little, if any, preferential tax treatment.

In 1987, 18,123 state employees reported on their Arkansas individual income tax returns $111,493,321 in retirement benefits, an average of $6,152 per person. Of those state employees 9,995 (in excess of 50% of the total state retirees) received less than $6,000, the amount of the exemption received for federal and other retirement benefits. These amounts are somewhat higher than normal due to incentives given by the state for early retirement in 1987. Approximately 32,000 federal retirees file Arkansas returns, or 3.4% of individual income tax return filers.

A potential loss of $44.7 million (the projected refund as of May 15, 1992) in the Net Available for Distribution under Arkansas 1993 Fiscal Year's Revenue Stabilization Law Allocations would result in dramatic reductions in the financing of the state's public education system, service delivery in the state's Medicaid program, opening of critical new correctional units and in financing current pay plans levels for state employees.

The Arkansas Constitution requires a balanced budget, and revenue shortfalls in fiscal year 1992 resulted in drastic cuts in key areas, including layoffs of employees. From a practical standpoint, such a reduction in the 1993 fiscal year would offer particular hardship since it would be falling on the heels of reductions made during the 1992 fiscal year.

Reductions in general revenue also result in financial loss to the state in the form of lost federal and other matching dollars. For example, if the loss of $4.3 million in general revenue in the Department of Human Services were taken in

the state's Medicaid program, there would be a compounded loss of almost $13 million in federal matching funds.

A specific formula is in place, under Revenue Stabilization Law Allocations, which determines what funds will be reduced. If $44.7 million is required to be paid out of the 1993 fiscal year budget, reductions would be as follows:

Public School Fund	$27,767,476
General Education Fund	205,637
Human Services Fund	4,261,199
State General Gov't Fund	1,473,967
Other Funds	2,881,100
Inst's of Higher Education	8,107,421
TOTAL	$44,696,801

Arkansas and other states are already experiencing difficulty in the Medicaid area due to certain federal mandates. As previously indicated, a refund of this magnitude hits in more than one area. The Medicaid budget and matching funds are both severely decreased.

Petitioners assert that their interests in relief outweigh any interest the state might have in prospective application. It is true that Petitioners have some interest in receiving monetary relief personally, but they cannot assert that they are acting on behalf of the federal government. This is not a requirement for intergovernmental tax immunity, but it is asserted as an equitable consideration favoring petitioner. Even if they could, the benefit in the form of enhanced federal income tax revenues cannot be determined here and should not be considered in this case. Petitioners have already received a reprieve from the tax declared unconstitutional in *Davis*. It is not necessary nor feasible to subsidize this benefit

with a refund at the expense of other residents of the state. *See Smith* at ___ , 110 L.Ed.2d at 162-63, 173.

III. Remedies are determined by state law and prospective relief is constitutionally sufficient.

Davis did not mention retroactivity, and Michigan conceded that Davis was entitled to a refund. Davis indicated on his Michigan income tax returns that he was paying "under protest" the tax on federal retirement benefits. Under Michigan's 90-day statute of limitations on constitutional grounds for protesting tax liability, Davis was indeed entitled to a refund if the tax was determined unconstitutional.

Based upon the facts in *Davis*, it was not necessary for this Court to consider the retroactivity issue. Simply stated, Michigan law provided that Davis was entitled to a refund. Once this Court decided the constitutional issue, there was a further issue of remedies. Remedies are determined by state law not by this Court, and Michigan law provided that a refund was the appropriate remedy. The remedy, i.e. the refund, was not decided by this Court. Justice Souter in his opinion in *Beam*, stated:

> Nothing we say here deprives respondent of his opportunity to raise procedural bars to recovery under state law or demonstrate reliance interests entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal.

Id. at 115 L.Ed.2d 494.

As this Court held in *McKesson*, if there is a pre-payment opportunity to object to a tax, due process does not

require post-payment remedies. Virginia and Amicus have such in place, and refunds are not required under those state laws.

In addition to Justice Souter's comment in *Beam*, this Court has addressed the importance of settled expectations and reliance interests recently in *Quill Corp. v. North Dakota*, 112 S.Ct. 1904 (1992) and *Allied-Signal, Inc. v. Director*, 112 S.Ct. 2251 (1992). The states involved in post-*Davis* litigation have had statutes on their books for up to forty-five years. Federal retirees have had annual opportunities to challenge these statutes. The few challenges made to these statutes have been on equal protection grounds. The states have dealt fairly with these retirees over the years. Present and future generations should not be required to suffer the possible consequences of retroactivity when the states had no reason to question these taxation and exemption statutes. No one would venture to say that state legislatures should cease passing statutes, which they believe in good faith are constitutional, in order to avert the possibility that the statutes are unconstitutional. Settled expectations and reliance interests should be considered here, and the decision should be to apply *Davis* prospectively only.

CONCLUSION

Nonretroactive application is not normally a desired result. Nevertheless, when, as in this case, retroactive application violates the purposes of the underlying law and creates a substantial hardship, nonretroactivity effects justice. *Davis* was a big victory for federal retirees that should not be overextended. A just result in this case will only occur if the Virginia Supreme Court is affirmed, with appropriate action being taken in other cases, pending before this Court, including *Pledger v. Bosnick*.

Respectfully submitted,

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No. 91-794

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF AMICI CURIAE THE VIRGINIA MANUFACTURERS ASSOCIATION, THE VIRGINIA CHAMBER OF COMMERCE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS/VIRGINIA, VIRGINIA RETAIL MERCHANTS ASSOCIATION, AND THE RETAIL MERCHANTS ASSOCIATION OF GREATER RICHMOND IN SUPPORT OF RESPONDENT

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF AMICI CURIAE THE VIRGINIA MANUFACTURERS ASSOCIATION, THE VIRGINIA CHAMBER OF COMMERCE, NATIONAL FEDERATION OF INDEPENDENT BUSINESS/VIRGINIA, VIRGINIA RETAIL MERCHANTS ASSOCIATION, AND THE RETAIL MERCHANTS ASSOCIATION OF GREATER RICHMOND IN SUPPORT OF RESPONDENT

INTERESTS OF THE AMICI CURAIE

Amici are five business and trade associations representing virtually the full spectrum of companies doing business in the Commonwealth of Virginia. These companies include both profit and not-for-profit corporations, state utilities, manufacturers, retailers, and defense contractors; and they run the gamut from new, fledging operations to large, well-established corporations. Together, the interests represented by these Amici account for the bulk of Virginia's gross domestic product.

The Virginia Manufacturers Association is a non-profit corporation representing 565 firms and has the goal of encouraging and supporting Virginia industries, and initiating and promoting constructive policies and activities on behalf of those industries. The Virginia Chamber of Commerce is a state-wide general business alliance of approximately 2000 members, which provides a voice for the general business community in promoting a healthy and prosperous economic climate. The National Federation of Independent Business/Virginia ("NFIB/Virginia") is the Commonwealth's largest small-business advocacy organization, with approximately 11,000 members that together employ well over 175,000 workers. NFIB/Virginia promotes the consensus view of small and independent business owners by supporting legislative and regulatory positions approved by majority vote of its members. The Virginia Retail Merchants Association is a broad-based trade group organized to lobby before the Virginia General Assembly, to educate its members and their customers in support of reasonable and proper laws for protection against trade abuses, and to foster understanding of retailing, free trade, and the free enterprise system. The Retail Merchants Association of Greater Richmond is a trade association with approximately 1500 members, serving the city of Richmond and the counties of Henrico, Hanover and Chesterfield. The Association provides educational services and advocates legislative and regulatory policies on behalf of its members.

Though the firms represented by Amici come from all over the Commonwealth and have highly diverse interests, they have one thing in common: a commitment to the economic health of Virginia and to the citizenry that depends upon that health. This commitment causes these Amici to care deeply about two fundamental principles of this Court: (1) stability and predictability in the law and the protection of economic reliance interests that develop around that law; and (2) an opportunity for

parties such as Amici to be heard by this Court before such reliance interests will be retroactively undermined.

It is clear to Amici that the result sought by the petitioners in this case threatens both of these fundamental principles. It is also clear that this result—the retroactive refund of nearly $500 million—would have a devastating impact on Virginia's economy, and consequently on Amici, for it would require significant reductions in vital state services, increases in taxes, or both, in a State already hard hit by the current recession.

Furthermore, the implications of such a result extend far byond this case. For if significant, retroactive refunds can be ordered here—where they would undermine substantial, good-faith reliance interests and where the prior understanding of the law was wholly justified and almost universally accepted—then refunds could be ordered in any case. Obviously, the constant threat of such retroactive liabilities would severely disrupt the climate for future investment in Virginia and in every other State.

Amici believe such a result would be economically disastrous, completely unfair to businesses, consumers and taxpayers alike, and directly contrary to the principles of this Court. They therefore file this brief strongly urging the Court not to reach this result.[1]

SUMMARY OF ARGUMENT

Acceptance of petitioners' arguments in this case would compromise two principles that lie at the bedrock of this Court's jurisprudence—stability in the law and the opportunity to be heard. Petitioners in this case have urged the Court to abandon the well-settled principles set forth

[1] This brief *amici curiae* is being filed with the consent of the parties, whose written statements of consent have been filed with the Clerk of the Court.

in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971), and impose enormous retroactive liability on twenty-three States, simply because a single party made a single concession in a brief filed several years ago with this Court in *Davis v. Michigan Department of the Treasury*, 489 U.S. 803 (1989). And petitioners would furthermore have the Court do so pursuant to the complete reformulation of retroactivity analysis announced in *James B. Beam Distilling Co. v. Georgia*, 111 S. Ct. 2439 (1991)—notwithstanding that *Davis* was briefed, argued, and decided before promulgation of the *Beam* rule. Because such a result does violence both to stability and to the opportunity to be heard, the Court should not accept it. Instead, the Court should apply the fairness and stability standards recognized in *Chevron Oil* and on that basis find *Davis* non-retroactive.

ARGUMENT

I. THIS COURT HAS LONG DEMONSTRATED A FUNDAMENTAL COMMITMENT TO ASSURING STABILITY AND PREDICTABILITY IN THE LAW AND TO PROVIDING PARTIES WITH AN OPPORTUNITY TO BE HEARD ON ISSUES THAT AFFECT THEIR INTERESTS.

This case implicates two fundamental principles of law: first, that legal rules should provide a stable and predictable backdrop against which individuals and businesses may order their affairs; and second, that parties should have an opportunity to be heard on issues that affect their vital interests, particularly where a court is considering retroactively reversing legal rules those parties long and reasonably relied on. Both these principles would be fatally compromised if this Court orders full retroactive refunds in this case.

A. Stability And Predictability In The Law.

The stability and predictability of the legal rules around which individuals plan their activities is a hallmark of

a civilized jursprudence. As Justice Harlan noted in *Boddie v. Connecticut*, 401 U.S. 371 (1971),

> Perhaps no characteristic of an organized and cohesive society is more fundamental than its erection and enforcement of a system of rules defining the various rights and duties of its members, enabling them to govern their affairs and definitively settle their differences in an orderly, predictable manner.

Id. at 374.

This need for stability and predictability is most critical in the economic domain, with which Amici are vitally concerned. Indeed, "[t]he classic case for weighing reliance interests heavily . . . occurs in the commercial context, where advance planning of great precision is most obviously a necessity." *Planned Parenthood of Southeastern Pennsylvania v. Casey*, 112 S. Ct. 2791, 2809 (1992) (plurality opinion) (citation omitted); *see also Payne v. Tennessee*, 111 S. Ct. 2597, 2610 (1991) (society's interest in settled law reaches its "acme in cases involving property and contract rights, where reliance interests are involved").

The Court has furthermore found the need for protection of reliance interests most acute in matters of tax planning and public finance.[2] As a result, the Court has insisted upon the most compelling circumstances before effecting a change in the law that would "defeat the reliance interest of those corporations which have structured their activities and paid their taxes based upon . . . well-established rules" and "disrupt settled expecta-

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[2] *See, e.g., American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167, 182-86 (1990) (plurality opinion); *United States v. Byrum*, 408 U.S. 125, 135 (1972) ("Courts properly have been reluctant to depart from an interpretation of tax law which has been generally accepted when the departure could have potentially far-reaching consequences"); *Cipriano v. City of Houma*, 395 U.S. 701, 706 (1969) (per curiam) (refusing to apply invalidation of municipal bond issuance retroactively).

tions in an area of the law in which the demands of the national economy require stability." *Allied-Signal, Inc. v. Director, Div. of Taxation*, 112 S. Ct. 2251, 2262 (1992). Given the current status of the economy—particularly in Virginia—this principle has never been more important. A stable economy cannot be constructed on shifting legal sands.

Until this case, Amici regarded the primary safeguard of stability—or at least the bulwark against unfair, retroactive changes—to be *Chevron Oil*. There, the Court re-emphasized the need for careful individualized assessment of the reliance and equitable interests engendered by an old legal rule before any new rule may be applied retroactively. 404 U.S. at 106-09. The equitable principles recognized in *Chevron Oil*—which date back hundreds of years—represent the crucial mainstay against the substantial disruption that can be engendered by the retroactive application of newly-announced legal rules. Although Amici agree that these principles must be applied with a view toward balancing the interests of *all* affected parties, a court should surely not apply a new rule retroactively without *ever* performing that balancing.

Yet that is what petitioners seek here. They say that *Davis* may be applied retroactively without a careful weighing of the fairness and impact of the result. This Court could not accept that outcome without abandoning its commitment to stability in the law and protection of well-founded reliance interests.

B. The Opportunity To Be Heard.

Affording an opportunity to be heard to those parties whose rights and duties will be significantly affected by an adjudication is a *core tenet* of this Court's jurisprudence. Indeed, this principle is the very cornerstone of due process. *See, e.g., Fuentes v. Shevin*, 407 U.S. 67, 80 (1972) ("For more than a century the central meaning of procedural due process has been clear: 'Parties

whose rights are to be affected are entitled to be heard. . . .'") (quoting *Baldwin v. Hale*, 68 U.S. (1 Wall.) 223, 233 (1864)).

Moreover, this principle applies to more than just the parties before the Court in a particular case. Rather, any decision, especially by this Court, necessarily has wide-ranging implications far beyond that particular case. Accordingly, before the Court contemplates altering the course of the law, it is essential that both "parties and amici ha[ve] the opportunity to apprise [the Court] of the impact of a change in the law." *R.A.V. v. City of St. Paul*, 112 S. Ct. 2538, 2551 (1992) (White, J., concurring).

This principle is particularly important where the retroactivity of a new rule is at issue, and particularly after this Court's decision in *James B. Beam Distilling Co. v. Georgia*, *supra*. For in that case, the Court announced for the first time that the question of retroactivity ordinarily will be decided *at the same time* as the substantive legal rule. But the Court also recognized that the retroactivity question necessarily involves consideration of "the equitable and reliance interests of parties absent but similarly situated." 111 S. Ct. at 2448. This recognition mandates that parties such as Amici—whose vital interests would be affected by a new legal rule—be given an opportunity to be heard on the question of retroactivity. And where retroactivity is at issue, this need for amici participation often is vital because resolution of the issue frequently depends on an evaluation of equities and interests that are unknown to the parties to the case.

For all these reasons, it is imperative that the opportunity to be heard be fully protected when retroactivity questions are at issue. Indeed, last Term, the Court plainly embraced this proposition when it contemplated establishing a new rule of law in *Allied-Signal*, *supra*, by calling for amicus curiae briefs specifically addressed to the question of retroactivity. *See* 112 S. Ct. at 2257. Yet

here, petitioners would have this Court conclude that the retroactivity of *Davis* has already been decided—without Amici or anyone else having addressed this issue. As further discussed below, the Court should not accept this result.

II. RETROACTIVE APPLICATION OF *DAVIS*, WITHOUT CONSIDERATION OF THE FACTORS REQUIRED BY *CHEVRON OIL*, WOULD BE A WHOLESALE DEPARTURE FROM STABILITY AND THE OPPORTUNITY TO BE HEARD.

Petitioners ask the Court to ignore completely the substantial economic disruption that would be caused by retroactive application of *Davis*, simply because the Court in *Davis* noted a single party's unilateral decision to provide a refund to a single claimant. Moreover, petitioners would have the Court do so under the wholly new standard announced in *Beam*, even though that case was decided after *Davis*. As will be shown, such a holding would be fundamentally unfair to Amici and the millions of other interested parties whose settled expectations would be seriously disrupted, where no party or amicus had reason to believe that it was required to argue the question of retroactivity in *Davis* itself.

A. It Would Be Fundamentally Unfair To Hold That *Davis* Applied Its Rule To The Parties In That Case.

It is clear that the retroactivity question was not decided in *Davis*, either explicitly or implicitly, and that the *Beam* rule therefore should not apply to this case. Indeed, Justice Souter's opinion in *Beam* reflects this Court's continued commitment to *stare decisis*—the principle that a matter, *once decided*, will not be continually revisited. Thus, under *Beam*, only when an opinion may be "fairly read" as having actually applied its rule retroactively to the parties before the Court should the rule be applied retroactively to other similarly situated litigants. 111 S. Ct. at 2445.

In *Davis*, however, the Court had no occasion to decide —and plainly did not decide—the question of retroactivity because the State of Michigan had already agreed to provide Mr. Davis with a refund should the Court invalidate its taxation scheme. This concession obviated any need to consider whether to apply the rule retroactively to the parties before the Court, and the Court's recognition of this fact certainly cannot be "fairly read" as having done so.

To hold otherwise, *i.e.*, to hold that Michigan's agreement to provide a small refund to a single taxpayer in a single case automatically renders twenty-two other States liable for over $2 billion in refunds, would greatly erode the principles of stability and opportunity to be heard. Indeed, such a holding would at one stroke both ignore *Chevron Oil*'s commitment to a careful *weighing* of the implications of retroactivity and also allow a question of enormous national consequence to be decided solely upon the stipulation of someone who did not even address the issue.[3]

These Amici submit that they, their employees and customers should not have their susceptibility to a crippling retroactive liability depend on the unilateral concession of a single party that was made four years ago. Plainly, *stare decisis* does not mandate such a result; on the contrary, that doctrine forbids preclusive effect in such situations. *See, e.g., County of Orange v. Air California*, 799 F.2d 535, 538-39 (9th Cir. 1986) (stipulation has no *stare decisis* effect), *cert. denied*, 480 U.S. 946 (1987).

Moreover, deciding retroactivity by default and *sub silentio* flies in the face of the Court's recognition that

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[3] *See* Brief for Appellees at 63-64, *Davis* (No. 87-1020) (conceding refund question but explicitly stating that "[e]ven assuming this remedy is appropriate for Appellant Davis, however, it is not necessarily appropriate for all others who may be similarly situated").

"the threshold determination whether a new decision should apply retroactively is a crucial one, *requiring a hard look at whether retroactive application would be unjust.*" *American Trucking Ass'ns v. Smith*, 496 U.S. at 181 (plurality opinion) (emphasis supplied). That determination plainly was not made in *Davis* and the Court should *now* take a "hard look" at the hardship and injustice that retroactive application would cause.

B. In Any Event, The *Beam* Rule Should Not Be Applied To Cases Decided Before *Beam*.

Even if *Davis* could be "fairly read" as having applied its rule to the parties in that case, *Beam* should not for that reason require retroactive application of *Davis* in this case. This is because *Beam* itself was not decided until after *Davis*.

Prior to *Beam*, when a case established a new rule of law and retroactivity was not raised by the parties or decided by the Court, other interested parties reasonably believed they would have an opportunity to argue the issue in a subsequent case. *See, e.g., Ashland Oil, Inc. v. Caryl*, 110 S. Ct. 3202 (1990) (deciding retroactivity in subsequent case); *Chevron Oil, supra* (same). *Davis* was precisely such a case, as retroactivity was neither decided by the Court, nor briefed or argued by the parties. Thus, no interested party, including Virginia and Amici, reasonably could have predicted that the Court would abandon its prior rule and consider the issue as having been decided.[4]

[4] *See, e.g., United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33, 38 (1952) (issue "not . . . raised in briefs or argument nor discussed in the opinion of the Court" is not *stare decisis*); *Webster v. Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents"). Indeed, it has long been held that even the Court's own exercise of jurisdiction—the validity of which the Court *must* address on its own—does not decide that question *sub silentio*. *See L.A. Tucker Truck Lines*, 344 U.S. at 38 (citing *Arant v. Lane*, 245 U.S. 166, 170 (1917), *Louisville Trust Co. v. Knott*, 191 U.S. 225, 236 (1903), *Cross v. Burke*, 146 U.S. 82, 87 (1892), *Snow v. United States*, 118 U.S. 346, 354 (1886), and *United States v. More*, 7 U.S. (3 Cranch) 159, 172 (1805)).

Justice Souter's opinion in *Beam* altered this landscape significantly, by decreeing that retroactivity is implicitly decided whenever a rule is applied to the parties in a case, thereby requiring other interested parties to weigh in on retroactivity *at that time*. Because *Beam* itself upset settled expectations on which other interested parties, including Amici, relied, fundamental fairness requires that this new approach to retroactivity not *itself* be applied to foreclose a full consideration of the retroactivity issues in this case. Otherwise, parties such as Amici would be held retroactively to have waived their opportunity to be heard regarding the retroactivity of cases decided before *Beam*.

Obviously, Amici could not and did not waive an opportunity to be heard in *Davis* that they did not know, prior to *Beam*, needed to be preserved. And just as obviously, to hold that retroactivity was implicitly decided in *Davis* under the *Beam* rule—even though *Davis* was decided before *Beam*—would completely undermine this Court's commitment to ensuring both stability in the law and an opportunity for interested parties to address any proposed destabilization. As this Court held in *Chevron Oil*, it would be inequitable to hold that Virginia or any other affected party " 'slept on [its] rights' at a time when [it] could not have known the . . . limitation that the law imposed upon [it]." 404 U.S. at 108. For all these reasons, *Beam* should not apply to this case to foreclose an analysis of the retroactivity of *Davis* under *Chevron Oil* principles.

III. WHEN THE MERITS OF THE RETROACTIVITY QUESTION ARE ADDRESSED, IT IS CLEAR THAT *DAVIS* SHOULD NOT BE APPLIED RETROACTIVELY.

When the merits of the retroactivity question are addressed under *Chevron Oil*, it becomes apparent, as the Virginia Supreme Court held, that *Davis* should not be applied retroactively. Forcing a refund of nearly $500 million in already-expended tax revenues would have the clear consequence of unfairly and unnecessarily defeating the well-founded reliance interests of Virginia, its citizens, and companies (such as those represented by Amici) doing business in the Commonwealth.

First, it is beyond question that *Davis* was a "new principle of law" that "decid[ed] an issue of first impression whose resolution was not clearly foreshadowed." *Chevron Oil*, 404 U.S. at 106.[5] Indeed, prior to *Davis*, Michigan's exemption and those of twenty-two other States had gone unchallenged for decades, and it was far from clear even to a trained lawyer's eye that the tax was invalid. *See Davis*, 489 U.S. at 818-28 (Stevens, J., dissenting); *see also Barker v. Kansas*, 112 S. Ct. 1619, 1626 (1992) (Stevens & Thomas, JJ., concurring); Richardson, *Federal Taxation of States*, 19 Stetson L. Rev. 411, 435 (1990) (*Davis* was a "surprising" decision).

Especially in the arena of tax and commercial law, where the need for predictability is at its zenith, the public cannot be required to "foresee" the evolution of such esoteric legal doctrines as that at issue in *Davis*. For businesses such as those represented by Amici, which must

[5] As the Fourth Circuit recently concluded, the invalidity of such exemptions "was not clearly established" prior to *Davis*. *Swanson v. Powers*, 937 F.2d 965, 967 (4th Cir. 1991), *cert. denied*, 112 S. Ct. 871 (1992). Writing for the court, Judge Wilkinson held: "We decline to proclaim in hindsight after the *Davis* decision that the unconstitutionality of differential tax exemptions had been clear all along." *Id.* at 968.

plan their investments and activities years into the future, it is vitally important that the law not impose such unforeseen shocks upon the economy. Obviously, unplanned retroactive tax increases, imposed without the benefit of legislative consultation and deliberation, will decrease the funds available to businesses for investment and expansion. Similarly, retroactive application of *Davis* would have a serious chilling effect upon the States' abilities to meet their pressing needs for new revenue sources. Indeed, petitioners "would have state officials stay their hands until newly enacted state programs are 'ratified' by the federal courts, or risk draconian, retrospective decrees should the legislation fail." *Lemon v. Kurtzman*, 411 U.S. 192, 207 (1973).

Second, it is clear that non-retroactivity would not frustrate the purpose of the *Davis* rule. *See Chevron Oil*, 404 U.S. at 107. That purpose was entirely prophylactic: "to protect each sovereign's governmental operations from undue interference by the other." *Davis*, 489 U.S. at 814 (citations omitted). Prospective application fulfills this goal. In the wake of *Davis*, Virginia and other States promptly eliminated their disparate tax treatments. Because there is no evidence that any State adopted its scheme with the intent to harm the federal government, retroactive application of *Davis* would serve no legitimate punitive goals, and such liability is unnecessary to deter future violations. Moreover, as petitioners are no longer employed by the federal government, providing refunds would do nothing to protect any "governmental operations"—the sole purpose of *Davis*.

Third, retroactive application of *Davis* would impose devastating financial hardship on Virginia, its citizens, and all those who do business in the Commonwealth. This Court has repeatedly refused to apply a new rule retroactively when the social costs of doing so would be

too great.[6] Here, it is beyond question that "[t]he fiscal implications of *Davis* for the states are truly staggering." Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes 325, 336 (July 16, 1990).

Because Virginia has more federal retirees than any other State, her refund exposure, recently estimated at $467 million, is the greatest of any State.[7] And "[t]his liability would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits." *Harper v. Virginia Dep't of Taxation*, 401 S.E.2d 868, 873 (Va. 1991). Compounding this problem is the fact that Virginia has been one of the States hardest hit by the current recession, and perhaps the slowest to climb out. During this recession, total nonagricultural employment fell by 5.3%, as compared with only 3.9% for the nation as a whole.[8] And because Virginia's economy is heavily dependent on defense spending—which continues to decline rapidly—its recovery will be significantly impeded. Thus, Virginia's ability to raise the required funds is severely hindered. As a plurality of this Court has noted, retroactive application of an unforeseeable change in tax law is unjust where "[a] refund . . . could deplete

[6] *See, e.g., Arizona Governing Committee for Tax Deferred Annuity and Deferred Compensation Plans v. Norris*, 463 U.S. 1073, 1091-95 (1983); *Northern Pipeline Constr. Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 88 (1982); *City of Los Angeles, Department of Water and Power v. Manhart*, 435 U.S. 702, 718-23 (1978); *Buckley v. Valeo*, 424 U.S. 1, 142 (1976) (per curiam); *Lemon*, 411 U.S. at 207-09 (1973).

[7] This figure is respondent's estimate of its potential refund liability through March 31, 1992.

[8] *See* Virginia Employment Comm'n, *Labor Market Review*, Vol. 4, No. 6, at 4 (June 1991) (Virginia employment as of June 1990); *id.*, Vol. 5, No. 5, at 5 (May 1992) (Virginia employment as of Feb. 1992); U.S. Dep't of Labor, Bureau of Labor Statistics, *Supplement to Employment & Earnings* 1 (Aug. 1992) (U.S. employment for same months).

the state treasury, thus threatening the State's current operations and future plans." *American Trucking Ass'ns v. Smith*, 496 U.S. at 182.

Moreover, the impact on Virginia's fiscal operations is only part of the story. Because the taxes which petitioners seek to have refunded have long since been spent on needed state services, Virginia would be force to increase taxes or drastically cut future services. Much of this liability would fall squarely on Amici's members, thereby affecting the entire economy. Indeed, it has been estimated that a $467 million individual tax increase in Virginia would cause the loss of $708 million to the economy as a whole and the loss of over 17,000 jobs, while a similar reduction in state services would cause the loss of $637 million and almost 14,000 jobs.[9] These losses are significant: a loss of 17,000 jobs would equal 35% of the 49,000 jobs lost in Virginia during 1990-91, one of the worst recession years in the recent history of the Commonwealth.[10] In the circumstances of this case, "[t]here is no justification for this Court . . . to impose this magnitude of burden retroactively on the public." *Norris*, 463 U.S. at 1107 (Powell, J., concurring and dissenting).

[9] The data on income and job loss were derived using the IMPLAN model, which is used regularly by the Virginia Employment Commission to forecast the effects of changes in public policy on the Virginia economy. *See* Reid, *An Overview of an Input-Output Modeling System: Personal Computer Version of IMPLAN* (May 1992) (available from Virginia Employment Commission); *id.* at App. D (listing previous studies). The data do not account for the potentially beneficial economic effects that could result from the expenditure of refund amounts in Virginia by recipients still residing there.

[10] *See* Virginia Employment Comm'n, *Labor Market Review*, Vol. 4, No. 6, at 4 (total nonagricultural employment as of Dec. 1990); *id.*, Vol. 5, No. 5 (May 1992) (total nonagricultural employment as of Dec. 1991).

CONCLUSION

The Court should not preclude itself—or these Amici—from addressing the *merits* of the retroactivity of *Davis*. When those merits are addressed, the pertinent equitable factors and the purposes of the *Davis* rule are best served by declining retroactive application.

Respectfully submitted,

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OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
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VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF THE NATIONAL GOVERNORS' ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL LEAGUE OF CITIES, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, U.S. CONFERENCE OF MAYORS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS AND COUNCIL OF STATE GOVERNMENTS, JOINED BY THE MULTISTATE TAX COMMISSION, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

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QUESTION PRESENTED

Whether this Court's decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989), should be applied retroactively.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1992

No. 91-794

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF OF THE NATIONAL GOVERNORS' ASSOCIATION, NATIONAL CONFERENCE OF STATE LEGISLATURES, NATIONAL LEAGUE OF CITIES, INTERNATIONAL CITY/COUNTY MANAGEMENT ASSOCIATION, U.S. CONFERENCE OF MAYORS, NATIONAL ASSOCIATION OF COUNTIES, NATIONAL INSTITUTE OF MUNICIPAL LAW OFFICERS AND COUNCIL OF STATE GOVERNMENTS, JOINED BY THE MULTISTATE TAX COMMISSION, AS *AMICI CURIAE* IN SUPPORT OF RESPONDENT

INTEREST OF THE *AMICI CURIAE*

The *amici* are organizations whose members include state, county, and municipal governments and officials throughout the United States. They have a compelling and continuing interest in the issue presented here: When should a judicial decision invalidating a state tax on federal constitutional grounds be applied retroactively?

This case concerns the retroactivity of the Court's decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989). *Davis* held that a State violates the intergovernmental tax immunity doctrine when it exempts retirement income paid to former state employees from tax-

ation but fails to grant a similar exemption to federal pensioners. The impact on *amici* of the Court's decision in this case cannot be overstated. At the time of *Davis*, twenty-three States had statutory exemptions similar to Michigan's; the potential refund liability of these States runs into the billions of dollars. In urging affirmance, *amici* thus seek to avert a fiscal disaster for many States. As state and municipal officials, *amici* well understand the profound, adverse impact that would follow from the retroactive application of *Davis* and are uniquely qualified to explain that impact. *Amici* also have a broader interest in the smooth operation of government, an interest jeopardized by the retroactive application, in the area of state taxation, of decisions establishing new rules of law. For all of these reasons, *amici* respectfully submit this brief to assist the Court in the resolution of this case.[1]

STATEMENT

In 1942, Virginia enacted a statute that exempted the retirement benefits of state employees from state income tax. Va. Code § 58.1-322(c)(3) (Michie 1988). For forty-seven years, the law remained intact and unchallenged. In 1989, this Court issued its decision in *Davis* v. *Michigan Dep't of Treasury*, 489 U.S. 803 (1989), holding that a Michigan statute similar to Virginia's violated the intergovernmental tax immunity doctrine because it did not grant a similar tax exemption to federal pensioners. After *Davis* was decided, petitioners, former federal employees, filed suit in state court seeking a refund of Virginia taxes levied on their federal retirement benefits. The Circuit Court denied the refunds on the ground that *Davis* applied prospectively only.

On appeal, the Supreme Court of Virginia affirmed. Pet. App. 7a. As a threshold matter, the court explained that this Court in *Davis* "did not decide whether its decision * * * had retrospective application," but rather relied

[1] The parties' letters of consent to the filing of this brief have been filed with the Clerk pursuant to Rule 37.3 of the Rules of this Court.

on a concession by the State of Michigan that Davis, individually, was entitled to a refund. *Id.* at 8a. *Davis*'s retroactivity, the Virginia Supreme Court held, accordingly was "governed by the three-pronged test announced in *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971)." Pet. App. 8a.

Applying that test, the court concluded that *Davis* should not be applied retroactively. *Davis* satisfied the first prong of *Chevron Oil*, the Virginia Supreme Court explained, because it " 'decid[ed] an issue of first impression whose resolution was not clearly foreshadowed.' " Pet. App. 10a (quoting *Chevron Oil*, 404 U.S. at 106). The court further explained that the second *Chevron Oil* factor—whether retrospective application would further the purposes of the intergovernmental tax immunity doctrine—also favored prospective application because the immunity doctrine's purpose was not to "prevent legitimate taxation," and because Virginia's statute, prior to *Davis*, authorized such legitimate taxation. Pet. App. 12a. In addition, the court noted, the Virginia General Assembly had taken immediate steps after *Davis* to amend the statute and thereby to equalize taxation of state and federal pensioners. *Ibid.* The third *Chevron Oil* factor also "weigh[ed] heavily in favor of" Virginia, the Virginia Supreme Court explained, since retroactive application of *Davis* would place inequitable burdens on the State. *Id.* at 14a. The court emphasized the fact, established by record evidence, that "retroactive application of the *Davis* decision would give rise to a potential tax refund liability * * * of $440,000,000." *Id.* at 13a-14a. "This liability," the court elaborated, "would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits" and thus "would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." *Id.* at 14a. Lastly, the Virginia Supreme Court also rejected petitioners' contention that they were entitled to a refund as a matter of state law. *Id.* at 14a-16a.

After this Court vacated the judgment and remanded for reconsideration in light of *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. 2439 (1991), the Supreme Court of Virginia reaffirmed its prior decision "in all respects." Pet. App. 5a. The court first summarized Justice Souter's approach to retroactivity, which provides that once a rule is applied to the litigants in a particular case, the rule also must be applied retroactively to all similarly situated litigants. That rule, the Virginia Supreme Court explained, had no application to the present case because this Court in *Davis* did not apply its ruling retroactively to the parties before it. *Id.* at 3a-4a. The court reiterated its earlier view (see *id.* at 8a) that "the issue of retroactivity was not considered by the Supreme Court in *Davis* because Michigan previously had agreed to the payment of a refund to Davis if its taxing scheme were invalidated." *Id.* at 4a. Finally, the court held that its prior resolution of the remedial issue as a matter of Virginia law was in no way affected by *Beam*. *Ibid.*

SUMMARY OF ARGUMENT

This case presents an issue of paramount importance to the States: When should a decision invalidating a state tax on federal constitutional grounds be applied retroactively? The implications of the Court's answer are far-reaching. To be sure, even under the test of *Chevron Oil Co.* v. *Huson*, 404 U.S. 97 (1971), the great majority of constitutional decisions issued by this and other federal courts in the area of state taxation will *not* announce a new rule of law, much less a new rule whose retroactive application would both thwart the rule's underlying purposes and, on balance, create inequitable burdens. But where, as here, all of these criteria are amply satisfied, retroactive effect can and often will force States and localities to make enormous refunds that threaten the availability of essential services and the fiscal well-being of government.

Given this potential for enormous liability, we submit that the Court should apply the three-part test articulated

in *Chevron Oil* to decide whether decisions in the area of state taxation are retroactive. As the Court has consistently recognized, "taxes are the life-blood of government." *Bull* v. *United States*, 295 U.S. 247, 259 (1935). When properly applied in this case, *Chevron Oil* requires a finding that *Davis* may be applied prospectively only. Accordingly, the judgment of the Virginia Supreme Court must be affirmed.

1. As an initial matter, the approach to retroactivity propounded by Justice Souter in *James B. Beam Distilling Co.* v. *Georgia*, 111 S. Ct. 2439 (1991)—which rejects "selective prospectivity"—does not mandate retroactive application of *Davis*. In *Davis*, the Court did not resolve a *federal* choice-of-law issue by applying the new constitutional rule announced in that case to Davis himself; instead, the Court simply noted Michigan's concession as a matter of *state law* that Davis (although not other Michigan taxpayers) would be entitled to a refund if he prevailed on the constitutional issue. Resolution of the federal choice-of-law question accordingly would have been not only unnecessary but also inappropriate. Needless to say, the Court did not purport to address that question.

2. The appropriate standard for determining retroactivity is set forth in the plurality opinion in *American Trucking Ass'ns, Inc.* v. *Smith*, 496 U.S. 167 (1990) (*"ATA"*), which employs the *Chevron Oil* test. That approach which is derived from longstanding principles of *stare decisis*, accords with what has been the general understanding of the Court's retroactivity decisions. It also takes account of the compelling considerations "of a practical sort" (*Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.)) that always have led the Court to limit the retroactive scope of its decisions in both the civil and criminal contexts.

3. Under the *Chevron Oil* test, *Davis* should not be applied retroactively. So far as the first prong of that test is concerned, *Davis* "disrupt[ed] a practice long accepted and widely relied upon." *United States* v. *Johnson*, 457 U.S. 537, 552 (1982) (citation omitted). Until that decision, tax exemptions such as the one in Michigan universally had been thought constitutional by taxing officials and taxpayers alike. Such exemptions had been on the books in States across the country for almost half a century. Yet so far as we are aware, until the *Davis* litigation *no* taxpayer in *any* jurisdiction had *even brought a challenge* to such a tax on intergovernmental immunity grounds, much less prevailed on such a claim. In such circumstances, taxing officials plainly were entitled to rely on the constitutionality of their statutes. That is particularly so because the Court's modern intergovernmental tax immunity decisions seemed to validate state levies—like those in Michigan and Virginia—that treated federal employees no less favorably than the ordinary run of state taxpayers. Since the other two prongs of *Chevron Oil* also point away from retroactive application of *Davis*, the Court should accord the *Davis* decision purely prospective effect.

ARGUMENT

THE RULE ANNOUNCED BY *DAVIS* SHOULD NOT BE APPLIED RETROACTIVELY

At the outset, two points warrant emphasis. *First*, it is useful to bear in mind those issues that are *not* involved here. This case does not present any challenge to the established understanding that refunds are unavailable to taxpayers who fail to comply with state statutes of limitations or rules requiring notice, payment under protest, or exhaustion of administrative remedies. Petitioners do not dispute the force of this principle, which was reaffirmed in *McKesson* v. *Florida Alcohol & Tobacco Div.*, 496 U.S. 18, 45 & n.28 (1990). See also, *e.g.*, *Ward* v. *Love County*, 253 U.S. 17, 22-23, 25 (1920). Similarly, this case does not pose the question whether *McKesson*—

which generally obligates States to provide "meaningful backward-looking relief" when their taxing schemes are held unconstitutional under clearly established law (496 U.S. at 31)—requires States to provide a refund remedy if they allowed taxpayers to protest the imposition of the unconstitutional tax prior to payment, as Virginia did in this case. If the Court holds *Davis* to apply retroactively, it accordingly should remand this case to the state courts for consideration of that remedial question. And if such "backward-looking" relief is held necessary here, it is, of course, for the individual States to determine whether the unconstitutionality should be remedied through the payment of refunds or through retroactive tax *increases* on the beneficiaries of the unconstitutional discrimination. See *McKesson*, 496 U.S. at 40.

Second, the Court should be cognizant of the practical consequences that would follow from retroactivity. On the one hand, it is plain that retroactive application of *Davis* (assuming that States are unable to increase taxes retroactively on state pensioners) would impose massive refund obligations on the States that would disrupt state operations across the country and throw the budgetary planning of many state and local governments into chaos. And on the other, retroactive application of *Davis* would offer petitioners a wholly unexpected and unwarranted windfall.

The liability that States would face if *Davis* is applied retroactively is, in the words of a leading commentator, "truly frightening." Hellerstein, *Preliminary Reflections on McKesson and American Trucking Associations*, 48 Tax Notes 325, 336 (July 16, 1990). As the Virginia Supreme Court found, Virginia *alone* would face liability of $440 million. Pet. App. 14a. But Virginia is decidedly not alone. Twenty-three States have statutes similar to those invalidated in *Davis*.[2] At least five of these

[2] Those States were Alabama, Arizona, Arkansas, Colorado, Georgia, Iowa, Kansas, Kentucky, Louisiana, Michigan, Mississippi, Missouri, Montana, New Mexico, New York, North Carolina,

States have potential refund liabilities of $100 million or more.[3] In all, our canvass of state taxing authorities suggests that the amount at stake across the country is on the order of $2 billion.

This massive liability, moreover, would come "at a time when most States are struggling to fund even the most basic services." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting). See Dickson, *New Study Quantifies States' Losses From Federal Cuts in Revenue Sharing*, The Bond Buyer, Mar. 19, 1992, at 2; Howlett, *A Coast to Coast Crisis: States Chase Every Penny of Revenue*, USA Today, Jan. 23, 1992, at A1; Armstrong, *Recession-Hit States Brace for Second Year of Budget Gaps*, Christian Science Monitor, Jan. 21, 1992, at 1. Even in times of fiscal health, it is difficult for States or localities suddenly to make unexpected outlays (or make up for unexpected revenue shortfalls) of many millions of dollars. With state treasuries already weakened, the potential liability following from retroactive application of *Davis* could cripple the essential operations of many state governments. The court below found that tax refund liability "would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits" and thus "would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." Pet. App. 14a. See

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Oklahoma, Oregon, South Carolina, Utah, Virginia, West Virginia and Wisconsin. See also Pet. App. 10a-11a n.2. For an explanation of each State's exemptions, see Eckl, Felde, Wolfe & Zimmerman, *State Taxation of Public Pensions: The Impact of* Davis v. Michigan, 47 Tax Notes 1119, 1122 (May 28, 1990).

[3] See *Bass* v. *South Carolina*, 395 S.E.2d 171, 174 (S.C. 1990) ($200 million), petition for cert. filed, 60 U.S.L.W. 3755 (U.S. Apr. 24, 1992) (No. 91-1687); *Bohn* v. *Waddell*, 790 P.2d 772, 789 (Ariz. Tax 1990) ($261 million), aff'd on reconsideration, 807 P.2d 1 (Ariz. Tax 1991); *Swanson* v. *North Carolina*, 407 S.E.2d 791, 794 (N.C.) ($140 million), on rehearing, 410 S.E.2d 490 (N.C. 1991), petition for cert. filed, 60 U.S.L.W. 3655 (U.S. Mar. 4, 1992) (No. 91-1436). See also Resp. Br. Supp. App. A (listing estimated liability of $120 million for Utah and $100 million for Georgia).

also *Bass*, 395 S.E.2d at 174 ($200 million refund liability would "endanger the fiscal integrity" of South Carolina); *Bohn*, 790 P.2d at 789 ($261 million in refunds would "endanger [Arizona's] financial integrity"). Needless to say, the ultimate burden of this liability would fall on "the shoulders of blameless or unknowing taxpayers" (*City of Newport* v. *Fact Concerts, Inc.*, 453 U.S. 247, 267 (1981)) in the form of higher taxes, reduced benefits, or both. See also *ATA*, 496 U.S. at 183 (plurality opinion).

At the same time, the beneficiaries of a refund in this case would receive an obvious windfall. Taxpayers such as petitioners, of course, already have benefited from a higher level of state services funded in part by their past tax payments. And as Justice O'Connor noted in a similar setting, "[b]efore [*Davis*], the legitimate expectation of [petitioners] was that they had to pay the tax here at issue and that it was constitutional. * * * There is little hardship to these [taxpayers] from not receiving a tax refund they had no reason to anticipate." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting).

It seems plain that these untoward consequences are earnestly to be avoided. The question in this case is whether they nevertheless are constitutionally compelled. We submit that they are not.

I. THE COURT SHOULD APPLY THE *CHEVRON OIL* TEST TO DETERMINE WHETHER NEW PRINCIPLES OF LAW CONTROL THE CASE BEFORE IT

Whether unsettling and disruptive retroactive consequences are avoidable when the law takes a radical change in direction, of course, is a matter that has closely divided the Court in recent years. In *ATA*, the plurality was of the view that decisions announcing new rules of law may not "appl[y] to conduct or events that occurred before the date of the decision" (496 U.S. at 177), and that retroactivity in such circumstances is governed by the three-part *Chevron Oil* test; as the plurality

saw it, determining which rule to apply was a "choice of law" question. See *id.* at 178. The *ATA* dissent, in contrast, concluded that the Court must apply its current understanding of the law in every case, while adding that equitable principles may be invoked in certain cases to limit the relief available to the prevailing party when the law has been changed. *Id.* at 209-210 (Stevens, J., dissenting).[4] One year after the decision in *ATA*, a different alignment of three Justices, without resolving the disagreement between the *ATA* plurality and dissent, added an additional level of inquiry: they rejected the use of "selective prospectivity," reasoning—entirely apart from the question whether pure prospectivity ever is permissible—that a new rule must be applied to all similarly situated litigants once it has been applied to one. See *Beam*, 111 S. Ct. at 2446 (opinion of Souter, J., joined by Stevens, J.); *id.* at 2448-2449 (White, J., concurring in the judgment).

The arguments bearing on all of the positions advanced in *ATA* and *Beam* were addressed at length in those decisions, and we do not propose to rehearse them here. Instead, we offer three propositions: 1) Accepting as correct the *Beam* plurality's rejection of selective prospectivity, we suggest that its position does not warrant retroactive application of *Davis*; 2) we maintain that the approach taken by the *ATA* plurality is the preferable one; and 3) we propose that the *Chevron Oil* test compels purely prospective application of *Davis*.

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[4] Petitioners are simply mistaken in asserting that "in *McKesson*, five justices of this Court rejected nonretroactive decisionmaking." Pet. Br. 19. The only discussion in *McKesson* of the retroactivity issue occurs in a brief footnote. See 496 U.S. at 31 n.15. Far from supporting petitioners' claim, that passage states in passing (and for a unanimous Court) that the decision of the Florida Supreme Court under review "clear[ly]" must be applied retroactively under any of the various "approaches advanced" in *ATA*. There was no need for the Court in *McKesson* to choose among those approaches since all yielded the same result: retroactivity.

A. *Beam* Is Inapplicable Because the *Davis* Court Did Not Apply the New Rule It Announced to the Parties in that Case

In *Beam*, three justices concluded that "it is error to refuse to apply a rule of federal law retroactively after the case announcing the rule has already done so." 111 S. Ct. at 2446 (opinion of Souter, J., joined by Stevens, J.); *id.* at 2448-2449 (White, J., concurring in the judgment). Finding this approach dispositive in *Beam*, Justice Souter explained that the rule announced in *Bacchus Imports, Ltd.* v. *Dias*, 468 U.S. 263 (1984), the decision whose retroactivity was at issue in *Beam*, had been applied in that case to the litigants, and thus also had to be applied retroactively in *Beam* to events predating *Bacchus*. 111 S. Ct. at 2441 (opinion of Souter, J.).

Contrary to petitioners' suggestion (Pet. Br. 6-10), Justice Souter's approach to retroactivity does not determine the outcome of this case. The reason is straightforward: the premise for that approach is absent here. In *Davis*, unlike in *Bacchus*, this Court did not "apply" its ruling of unconstitutionality to Davis within the meaning of *Beam*.

In fact, the Court simply had no occasion to reach or resolve the federal choice-of-law issue in *Davis*. Michigan there conceded—as a matter of *state law*—that Davis would be entitled to a refund if the state tax were held unconstitutional. The Court expressly accepted that concession, explaining: "The State having conceded that a refund is appropriate in these circumstances, see Brief for Appellee 63, to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund." 489 U.S. at 817 (citation omitted). Resolution of the federal question whether the holding of *Davis* should be given retroactive application therefore simply was unnecessary.[5] Needless to say, the Court did not

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[5] That Michigan premised its position on state law rather than on its understanding of the proper choice of federal law is made mani-

purport to resolve that question. Cf. *Desist* v. *United States*, 394 U.S. 244, 258 (1969) (Harlan, J., dissenting) ("This Court is entitled to decide constitutional issues only when the facts of a particular case *require* their resolution for a just adjudication of the merits.") (emphasis in original).

In this regard, the contrast with *Beam* is instructive. There, Justice Souter reasoned that *Bacchus* "is fairly read to hold as a choice of law that its rule should apply retroactively to the litigants then before the Court." 111 S. Ct. at 2445. In reaching this conclusion, Justice Souter noted both that "the *Bacchus* opinion did not reserve the question whether its holding should be applied to the parties before it" (*ibid.*)—a reservation that was rendered unnecessary in *Davis* by Michigan's concession as

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fest by the limited nature of its concession. Michigan acknowledged liability only to Davis; it expressly declined to make a similar concession in regard to any of the other 24,000 or so Michigan taxpayers whom the State predicted might seek the benefit of the Court's constitutional ruling. No. 87-1020, Br. Appellees 59, 63-64 ("Even assuming this [refund] remedy is appropriate for Appellant Davis, however, it is not necessarily appropriate for all others who may be similarly situated."). In addition, it was emphasized at argument that the concession did not settle the choice-of-law issue. At the close of his argument, Michigan's attorney stated, "[s]hould we lose all our substantive arguments, we admit that Mr. Davis should get his tax refund with interest, but the question arises what about these other 24,000 people." Tr. Or. Arg. 37. In response, the following exchange took place:

> Court: So, why do we have to answer that at all?
>
> Michigan: —if, if this Court issues an opinion stating that the current Michigan classification is unconstitutional or in violation of the statute, there are these 24,000 taxpayers out there.
>
> * * * *
>
> Court: But that's not—it's not here, is it? Is that question here?
>
> Michigan: It is not specifically raised, no.

Id. at 37-38. This conclusion is not disputed by petitioners, who recognize that "Michigan did not concede that the Court's decision would apply retroactively." Pet. Br. 8 n.3.

to the import of its state law—and that the Court in *Bacchus* expressly addressed the matter of remedies. As he explained, "any consideration of remedial issues necessarily implies that the precedential question has been settled to the effect that the rule of law will apply to the parties before the Court. Because the Court in *Bacchus* remanded the case solely for consideration of [a remedial question], it thus should be read as having retroactively applied the rule there decided." *Ibid.* (citation and footnote omitted).[6] The *Davis* Court, in contrast, while remanding for consideration of *prospective* remedies (see 489 U.S. at 817-818), said nothing about retroactive remedies for parties not covered by the State's concession.

It should be added that treating such a state-law concession as settling the choice-of-law issue for all parties in all future litigation would have patently absurd results. It would mean that the discretionary refund policy of the first State to engage in litigation would bind all other States. It also would lead all parties with an interest in the retroactivity of a constitutional rule to participate in all litigation involving that rule so that they could have a say on the choice-of-law issue.

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[6] Justice Souter also noted, but did not rely upon, the additional fact that in *Bacchus* the defendant discussed the applicability of *Chevron Oil* in its brief and urged the Court to apply any new constitutional rule prospectively only, and that, accordingly, the issue "can * * * be said actually to have been litigated and by implication actually to have been decided" by the Court. See 111 S. Ct. at 2445 n.2. In contrast, the issue of retroactivity was not even properly *presented* to the Court in *Davis*. The question presented by *Davis*'s Jurisdictional Statement was: "Whether Section 30(1)(h) of the Michigan Income Tax Act * * * *is invalid*, as applied to Federal retirees * * *." No. 87-1020 Juris. Statement i (emphasis added). This Court does not decide issues that are not presented. See S. Ct. Rule 14.1(a); *San Francisco Arts & Athletics, Inc.* v. *United States Olympic Comm.*, 483 U.S. 522, 547 n.30 (1987). In addition, in *Davis* the issue of retroactivity had not been reached by the Michigan Supreme Court. "Ordinarily," of course, "the Court does not decide questions not raised or resolved in the lower court." *Youakim* v. *Miller*, 425 U.S. 231, 234 (1976).

What is more, neither of the two rationales advanced by Justice Souter for his approach—"that similarly situated litigants should be treated the same" and *stare decisis* (111 S. Ct. at 2446)—has any application in a case such as this, where a court declines to reach or resolve an issue solely because of one party's concession. Self-evidently, Davis's "treat[ment]" resulted from Michigan's concession. It accordingly would offend no principle of equality to decline to extend the benefit of Michigan's concession to other taxpayers with identical claims: Davis is not situated similarly to other litigants, such as petitioners here, who have not obtained concessions from their adversaries in litigation and who are not entitled to refunds under the law of their States.

Nor does the principle of *stare decisis* support retroactive application of *Davis*. A prior decision of this Court "is not a binding precedent" on an issue that was not "raised in briefs or arguments nor discussed in the opinion." *United States* v. *L.A. Tucker Truck Lines*, 344 U.S. 33, 38 (1952). See also *Webster* v. *Fall*, 266 U.S. 507, 511 (1925) ("Questions which merely lurk in the record, neither brought to the attention of the court nor ruled upon, are not to be considered as having been so decided as to constitute precedents."). Indeed, this Court has not considered itself bound even by prior rulings that *necessarily decided* an issue *sub silentio*. *New* v. *Oklahoma*, 195 U.S. 252, 256 (1904) (citing *United States* v. *More*, 7 U.S. (3 Cranch) 159, 172 (1805) (Marshall, C.J.)). *A fortiori*, there is no binding force to a decision with respect to an issue that is not resolved. See Re, *Stare Decisis*, 79 F.R.D. 509, 511 (1975). Any benefit that Davis received from this Court's constitutional ruling in his case resulted not from the Court's resolution of the retroactivity or refund issue but from the voluntary action of his adversary in litigation. There is simply no *stare decisis* concern implicated under these circumstances. Cf. *Local No. 93, Int'l Ass'n of Firefighters* v. *Cleveland*, 478 U.S. 501, 522 (1986) (obligations in a consent decree are created by "the agreement

of the parties, rather than the force of the law upon which the complaint was originally based").

Because Justice Souter's approach in *Beam* has no application here, this case presents the Court with the choice left unresolved in *ATA*: between *Chevron Oil* and automatic retroactivity. It is to that question that we now turn.

B. The *ATA* Plurality's Application of the *Chevron Oil* Test Should Govern This Case

The controlling precedent here is *ATA*, and the dispositive question is whether to apply the approach to retroactivity taken by the *ATA* plurality or the *ATA* dissent.[7] We submit that the *ATA* plurality's approach

[7] In an effort to escape the force of *Chevron Oil*, petitioners attempt to recast this case in purely statutory terms. Pet. Br. 11-18. Thus, they argue that this case is "not about retroactive versus prospective application of *Davis*" at all, but rather is "about application of 4 U.S.C. § 111," the Public Salary Tax Act of 1939. Pet. Br. 17. They further suggest that "separation of powers require[s] this Court to honor and enforce" that statute, which took effect in 1939, according to what petitioners view as its "unambiguous" terms. *Id.* at 17-18.

These arguments are meritless. In *Davis*, this Court found the Public Salary Act to be *coextensive* with the immunity granted by the Constitution. *Davis*, 489 U.S. at 813-814 (the "immunity in [the Act] is coextensive with the prohibition against discriminatory taxes embodied in the modern constitutional doctrine of intergovernmental tax immunity. * * * [T]he scope of the immunity * * * is to be determined by reference to the constitutional doctrine."). Indeed, the *Davis* Court found it unnecessary even to resolve the question "whether § 111 provides an independent basis for finding immunity or merely preserves the traditional constitutional prohibition against discriminatory taxes." 489 U.S. at 813. Because the scope of the Salary Act is determined by the scope of the Constitution, petitioners' argument is simply inapplicable in this case.

In any event, petitioners' distinction between constitutional and statutory decisions has no substance. In fact, this Court often has refused to apply retroactively a decision that gives new meaning to a federal statute when the equities weigh against such application —as was true in *Chevron Oil* itself. The Court there declined to give retroactive effect to a prior decision, *Rodrigue* v. *Aetna Cas. &*

better accords both with this Court's precedents and with the general understanding of retroactivity, especially as applied to cases involving state taxation. Several points support this conclusion.

1. As an initial matter, whether or not the *ATA* dissent's characterization of retroactivity as a matter of remedy alone is, strictly speaking, consistent with the Court's prior holdings, that characterization appears out of step with the Court's past understanding of its decisions. The Court's civil rulings limiting retroactivity typically contain language indicating that the "the decision will not apply" to past conduct, or that "we will apply our decision in this case prospectively." *Cipriano* v. *City of Houma*, 395 U.S. 701, 706 (1969). See, *e.g.*, *Chevron Oil*, 404 U.S. at 106-107 ("'a holding of nonretroactivity'"); *Phoenix* v. *Kolodziejski*, 399 U.S. 204, 214 (1970) ("[o]ur decision in this case will apply only to" specified conduct). Cf. *Heckler* v. *Mathews*, 465 U.S. 728, 746 (1984) ("We have recognized, in a number of contexts, the legitimacy of protecting reasonable reliance on prior law even when that requires allowing an unconstitutional statute to remain in effect for a limited period of time."). This sort of language—stating that "a decision will not apply" to past conduct—surely is most naturally read as meaning that the *rule* announced in that decision will not apply. The lower courts, practitioners, and commentators therefore have understood the Court's retroactivity decisions to state "a doctrine or set of rules for determining when past precedent should be applied to a case before the court." *ATA*, 496 U.S.

Surety Co., 395 U.S. 352 (1969), which had construed the Outer Continental Shelf Lands Act in such a way as to create a new rule of law. See 404 U.S. at 99, 105-109. See also, *e.g.*, *Florida* v. *Long*, 487 U.S. 223, 235 (1988) (holding prior decision interpreting Title VII nonretroactive); *Chicot County Drainage Dist.* v. *Baxter State Bank*, 308 U.S. 371, 384 (1940) (recognizing that a later interpretation of a statute need not be given retroactive effect). Petitioners' belabored attempts to distinguish these cases (Pet. Br. 15-17) must be rejected.

at 196 (Scalia, J., concurring in the judgment). See also *id.* at 195-196 & n.2 (citing commentary).

The reasons that have impelled the Court to adopt that approach to retroactivity are manifest. Public officials and the citizenry at large are entitled to rely on this Court's statements of the law, and "[t]he utility of [the Court's] retroactivity doctrine in cushioning the sometimes inequitable and disruptive effects of law-changing decisions is clear." *ATA*, 496 U.S. at 200 (Scalia, J., concurring in the judgment). There accordingly is no compelling reason to depart from the long-settled understanding that, "'[w]here a decision of this Court could produce substantial inequitable results if imposed retroactively, there is ample basis in [the Court's] cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity.'" *Chevron Oil*, 404 U.S. at 107 (quoting *Cipriano*, 395 U.S. at 706).

It nevertheless has been suggested that the disruptive effects of mandatory retroactivity actually serve valuable purposes by discouraging departures from precedent and acting as a "check[] upon judicial law making." *Beam*, 111 S. Ct. at 2451 (Scalia, J., concurring in the judgment). For our part, however, we question whether society is well served by a rule that puts the Court to the choice of, on the one hand, retaining in force a concededly incorrect understanding of the Constitution (a choice that is particularly unpalatable to those who believe that judges should make law "as though they were 'finding' it" (*ibid.* (emphasis omitted)), or, on the other, causing potentially intolerable disruptive effects by its holdings.[8]

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[8] In any event, the *ATA* dissent itself acknowledges that the Court often will be able to cushion the impact of its decisions through the choice of a nonretroactive *remedy*. Its approach therefore is a very imperfect check upon judicial action: it is difficult to see how the force of precedent is significantly furthered by a choice-of-law rule that discourages the overruling of decisions only in those areas where the Court fortuitously has no remedial discretion. Allowing the nature of the choice-of-law rule to be dictated by the perceived

2. The principal challenge to the approach of the *ATA* plurality has been grounded upon the suggestion that limiting retroactivity somehow is inconsistent with the judicial role. See *Beam*, 111 S. Ct. at 2449-2450 (Blackmun, J., concurring in the judgment); *id.* at 2450-2451 (Scalia, J., concurring in the judgment). But there plainly is no Article III or other constitutional defect in the *ATA* plurality's approach. The Court repeatedly has held that there is no constitutional requirement of retroactivity. See, *e.g.*, *United States* v. *Johnson*, 457 U.S. 537, 542 (1982) (citing *Great Northern Ry.* v. *Sunburst Oil & Refining Co.*, 287 U.S. 358, 364 (1932)). And the formal notion that judges "find" rather than "make" rules does not dictate retroactivity; the Court consistently has refused to "'indulge in the fiction that the law now announced has always been the law.'" *Chevron Oil*, 404 U.S. at 107 (citation omitted). See, *e.g.*, *Williams* v. *United States*, 401 U.S. 646, 651 (1971) (plurality opinion) (Court has "firmly rejected the idea that all new interpretations of the Constitution must be considered always to have been the law and that prior constructions to the contrary must always be ignored"); *Linkletter* v. *Walker*, 381 U.S. 618, 622 n.3 (1965).

There undeniably was, moreover, a real controversy between the parties in *Davis*—and there would have been such a controversy even had the Court there held its decision to be nonretroactive and even had Michigan not made the concession that entitled Davis to relief. In such circumstances, a holding of nonretroactivity is hardly advisory; the Court's opinion in such a case simply explains its rationale for choosing a particular rule and applying that rule (or failing to apply it) to particular facts. A decision of that sort is similar in principle to, and relies upon the same considerations of policy as, a conclusion that a prior holding was wrongly decided but should not be overruled so as to protect the litigants'

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value of retroactivity in those cases would have a very small practical tail wagging a very large theoretical dog.

(and the public's) reliance interests. See, *e.g.*, *Flood* v. *Kuhn*, 407 U.S. 258, 282-284 (1972).

In fact, as the *ATA* plurality explained, principles of nonretroactivity long have been understood to be an element of the doctrine of *stare decisis*. *ATA*, 496 U.S. at 196 (citing *Sunburst*, 287 U.S. at 364 (Cardozo, J.)). Certainly, if it is appropriate for the Court to protect the public's expectation interests by declining to overrule a decision that is thought to have been wrongly decided, cf. *Quill* v. *North Dakota*, 112 S. Ct. 1904, 1914-1916 (1992), it is equally proper to allow courts, by means of prospective overruling, "to respect the principle of *stare decisis* even when they are impelled to change the law in light of new understanding." *ATA*, 496 U.S. at 197 (plurality opinion). Justice Scalia offered a related analysis in *ATA*, where he concluded that a Justice who disagrees with a decision that overruled precedent may decline to apply that decision to conduct that had been undertaken in reliance on the precedent; in such circumstances, *stare decisis* principles permit a departure from the more recent decision so as not to "upset * * * settled expectations." *Id.* at 205 (Scalia, J., concurring in the judgment). We add only that if Justice Scalia's understanding of *stare decisis* is correct—and we believe it is—it is not at all clear why it is inconsistent with the judicial role for a judge who *agrees* with a decision to decline to apply that decision's rule so as to protect those same expectation interests.

There is nothing new in this conclusion. This Court consistently has taken into account such considerations "of a practical sort" in determining the retroactive reach of its decisions. *Beam*, 111 S. Ct. at 2443 (opinion of Souter, J.). In civil cases, for example, the Court will not allow "a new rule [to] reopen the door already closed" by principles of res judicata or by statutes of limitations, even though those limits on retroactivity are in some sense "arbitrary" (*id.* at 2446); the Court denies complete retroactive effect to the new rule so as to advance independent interests in finality. See *id.* at 2447. The

Court has applied the same sort of practical judgment in its application of retroactivity in the setting of habeas corpus, adopting an approach, first propounded by Justice Harlan in *Mackey* v. *United States*, 401 U.S. 667, 675 (1971) (opinion of Harlan, J.), that accords most constitutional decisions nonretroactive effect in habeas proceedings. *Teague* v. *Lane*, 489 U.S. 288, 299-310 (1989) (plurality opinion). And again, if considerations of finality and reliance may justify disregard of "current constitutional law" in such proceedings (*Mackey*, 401 U.S. at 686 (opinion of Harlan, J.)), there is no reason to find it inconsistent with the judicial function for a judge, looking to similar policies, to decline to apply new law in a case such as this one.

It hardly need be added that, as we explain above, there *are* compelling practical considerations that militate against retroactive application of new constitutional principles in cases involving state taxation. And this Court has taken such fiscal considerations into account in deciding cases that affected the financial well-being of States. In *Arizona Governing Comm.* v. *Norris*, 463 U.S. 1073, 1106-1107 (1983), for example, Justice Powell, writing for five Members of the Court, stressed the "devastating results" that would follow from imposing massive retroactive liability on state and local governments. *Id.* at 1106. As Justice Powell explained, "[i]mposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Id.* at 1106-1107. Here, as in *Norris*, there is "no justification * * * to impose this magnitude of burden retroactively on the public." *Id.* at 1107. See also *id.* at 1110 (O'Connor, J., concurring).

II. UNDER THE *CHEVRON OIL* TEST, *DAVIS* SHOULD NOT BE APPLIED RETROACTIVELY

If the Court follows the approach set out by the *ATA* plurality, it must apply the *Chevron Oil* test to its holding in *Davis*. The test's three parts are now familiar:

> First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed. Second, * * * we must * * * weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective application will further or retard its operation. Finally, we [must] weigh[] the inequity imposed by retroactive application, for where a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the injustice or hardship by a holding of nonretroactivity.

404 U.S. at 106-107 (citations and internal quotation marks omitted). See *ATA*, 496 U.S. at 179 (plurality opinion). This test requires that *Davis* not be applied retroactively.

1. The *Chevron Oil* test is designed "to determine the equities of retroactive application of a new rule" (*Beam*, 111 S. Ct. at 2452 (O'Connor, J., dissenting)); its first prong is used to identify those parties who reasonably relied upon the old rule and who accordingly would be denied "basic * * * justice and fairness" if subjected to the new one. *Id.* at 2444 (opinion of Souter, J.). One way of establishing such reliance is by demonstrating that the decision whose retroactivity is at stake marked a break with the Court's existing doctrine—and we show below that *Davis* did mark such a break. But other features of the legal landscape, such as long-standing, universal acceptance of the old rule by affected persons, also may shed light on the reasonable expectations of the parties. Here, a review of that landscape makes clear that *Davis* did "decid[e] an issue of first impression whose resolution was not clearly foreshadowed."[9]

[9] Notwithstanding petitioners' asertion to the contrary (see Pet. Br. 20-23), this formulation still expresses the first prong of the *Chevron Oil* Test. See, *e.g.*, *ATA*, 496 U.S. at 179 (plurality opin-

It is beyond dispute that *Davis* "disrupt[ed] a practice long accepted and widely relied upon." *United States* v. *Johnson*, 457 U.S. at 552 (citation omitted). Until the decision in *Davis*, taxes such as those in Virginia and Michigan universally had been thought constitutional by taxing officials and taxpayers alike. Virginia's tax had been on the books for almost half a century. Similar statutes were enforced by just under half the States.

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ion). Petitioners argue that this Court, in two brief *per curiam* opinions, abandoned the "clearly foreshadowed" standard in favor of an inquiry into whether a rule announced in a judicial decision is "revolutionary." See Pet. Br. 21-22 (citing *Ashland Oil, Inc.* v. *Caryl*, 110 S. Ct. 3202 (1990), and *National Mines Corp.* v. *Caryl*, 110 S. Ct. 3205 (1990)). Petitioners are mistaken. In fact, *Ashland Oil* expressly *reaffirmed* that "[t]he first prong of the *Chevron Oil* test requires that 'the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, or by deciding an issue of first impression whose resolution was not clearly foreshadowed.'" 110 S. Ct. at 3204 (quoting *Chevron Oil*, 404 U.S. at 106-107); see also *id.* at 3205 (applying this test); *National Mines*, 110 S. Ct. at 3206 (summarily adopting reasoning and result of *Ashland Oil*). The Court's observation, in *Ashland Oil*, that a certain decision may well have "revolutionized" an area of law was made in reference to a case decided *after* the decision whose retroactivity was under consideration. Nor does *Goodman* v. *Lukens Steel Co.*, 482 U.S. 656, 662-663 (1987), "demonstrate that decisions that do not overturn Supreme Court precedent are not even candidates for prospective-only application." Pet. Br. 20. In *Lukens*, this Court merely applied the traditional *Chevron Oil* test and held that a Third Circuit decision that had overruled several prior Third Circuit cases was nonetheless retroactive, because the conduct underlying the lawsuit occurred years before the earlier decisions had been rendered. 482 U.S. at 662-663. Finally, petitioners are incorrect in suggesting that under *Owen* v. *City of Independence*, 445 U.S. 622 (1980), "when[ever] governmental entities are involved, *Chevron* may only apply in cases overturning precedent of this Court." Pet. Br. 22. Similar arguments were rejected by eight members of the Court in *ATA*. See 496 U.S. at 184 (plurality) ("*Owen* is not applicable * * * here."); see also *id.* at 216 n.5 (Stevens, J., joined by Brennan, Marshall & Blackmun, JJ., dissenting) (explaining that plurality "is technically correct that *Owen* did not hold that constitutional decisions should always apply 'retroactively'").

Yet so far as we are aware, until the *Davis* litigation, *no* taxpayer in *any* jurisdiction had even *brought a challenge* to such a statute on intergovernmental tax immunity grounds, much less prevailed on such a claim. To the contrary, as Judge Wilkinson recently noted for the Fourth Circuit, "[t]he most pertinent judicial decisions had upheld comparable taxing schemes." *Swanson* v. *Powers*, 937 F.2d 965, 968 (4th Cir. 1991), cert. denied, 112 S. Ct. 871 (1992). See 937 F.2d at 969.

In such circumstances, where similar state statutes had stood across the nation for almost 50 years without so much as a single challenge, state taxing officials would have been entitled to rely on the constitutionality of their laws even had close analysis of this Court's pre-*Davis* authority arguably pointed toward the ultimate outcome in that case. See *Bohn*, 790 P.2d at 783; *Swanson* v. *North Carolina*, 407 S.E.2d at 794; *Bass*, 395 S.E.2d at 174. Indeed, to impose retroactive liability in such circumstances would subject state officials to extraordinarily awkward and conflicting obligations. "[A] regime requiring refunds even when a finding of unconstitutionality would be highly unpredictable could both discourage the states from exploring new tax policies and unreasonably penalize adherence to old ones." Fallon & Meltzer, *New Law, Non-Retroactivity, and Constitutional Remedies*, 104 Harv. L. Rev. 1733, 1831 (1991). State legislators hardly can be expected to repeal tax statutes that are in use across the nation, that are not plainly inconsistent with judicial authority, and that have not even had their validity called into question. And state taxing officials typically are bound under state law to enforce presumptively valid statutes until directed otherwise by the courts. If States may be forced to surrender funds collected pursuant to such statutes, their ability to plan or carry out government programs will be seriously compromised.

Noting just such considerations, the Court in a related setting rejected a constitutional challenge that "would

have [had] state officials stay their hands" until their programs were

> "ratified" by the federal courts, or risk draconian, retrospective decrees should the legislation fall. In our view, [this] position could seriously undermine the initiative of state legislators and executive officials alike. Until judges say otherwise, state officers * * * have the power to carry forward the directives of the state legislature.

Lemon v. *Kurtzman*, 411 U.S. 192, 207-208 (1973) (plurality opinion). In the absence of compelling constitutional considerations mandating retroactivity (see *id.* at 201-203), the *Lemon* plurality added that "[w]e do not engage lightly in post hoc evaluation of such political judgment, founded as it is on 'one of the first principles of constitutional adjudication—the basic presumption of the constitutional validity of a duly enacted state or federal law.'" *Id.* at 208 (quoting *San Antonio School District* v. *Rodriguez*, 411 U.S. 1, 60 (1973) (Stewart, J., concurring)). While the Court in *Lemon* was specifically addressing questions of remedy rather than choice of law, its underlying premise is equally applicable here: "[A]bsent contrary direction, state officials and those with whom they deal are entitled to rely on a presumptively valid state statute, enacted in good faith and by no means plainly unlawful." 411 U.S. at 208-209 (plurality opinion).

2. While that is enough to satisfy the first prong of *Chevron Oil*, it should be added that this Court's pre-*Davis* precedent did *not* "clearly foreshadow" the outcome there. To the contrary, as Judge Wilkinson explained, "the rationale behind the precedent might have suggested a different result in that case." *Swanson* v. *Powers*, 937 F.2d at 970. To begin with, as this Court has frequently observed, the doctrine of intergovernmental tax immunity has "been marked from the beginning by inconsistent decisions and excessively delicate distinctions." *United States* v. *New Mexico*, 455 U.S. 720, 730 (1982). See also *United States* v. *City of Detroit*, 355 U.S. 466, 473

(1958) (doctrine a "much litigated and often confused field").[10] But to the extent that there had been any trend in the law prior to *Davis*, it was away from an expansive view of immunity. Indeed, in the years preceding *Davis*, the Court repeatedly had restricted the scope of the immunity doctrine. See *Swanson* v. *Powers*, 937 F.2d at 970 ("the modern line of cases represents a shift in emphasis away from immunity and toward limitation of such immunity."). That trend began in 1937, with the Court's decision in *James* v. *Dravo Contracting Co.*, 302 U.S. 134 (1937), which held that even though a "tax may increase the cost to the Government, that fact would not invalidate the tax." *Id.* at 160. In more recent years, the Court repeatedly denied claims of immunity and granted the States broader authority to exercise their taxing powers.[11]

In nevertheless finding Michigan's statute unconstitutional, the *Davis* Court relied upon the principle, derived from *Phillips Chem. Co.* v. *Dumas Indep. School Dist.*, 361 U.S. 376 (1960), that "'it does not seem too much to require that the State treat those who deal with the [federal] Government as well as it treats those with whom it deals itself.'" 489 U.S. at 815 n.4 (quoting *Phillips*,

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[10] Lower courts and commentators alike concur in this assessment. See, *e.g.*, *Swanson* v. *Powers*, 937 F.2d at 968 (before *Davis* "the doctrine of intergovernmental tax immunity was, at best, ambiguous"); *Bohn*, 790 P.2d at 784 (the doctrine of intergovernmental tax immunity is "a most esoteric of constitutional philosophies"); L. Tribe, *American Constitutional Law* § 6-31, at 514 (1988) (noting a "sometimes bewilderingly complex array of judicial decisions in this area"); P. Hartman, *Federal Limitations on State and Local Taxation* § 6:1, at 221 (1981) ("Since its inception, federal tax immunity has wound its way through a maze of shifting judicial interpretations and approaches. * * * In truth, during different eras in our constitutional history, there have been virtual judicial summersaults in the field * * *.").

[11] See, *e.g.*, *California State Board of Equalization* v. *Sierra Summit, Inc.*, 490 U.S. 844, 848 (1989); *United States* v. *New Mexico*, 455 U.S. at 742; *United States* v. *County of Fresno*, 429 U.S. 452 (1977); *City of Detroit*, 355 U.S. at 475.

361 U.S. at 385). But in its more recent pre-*Davis* intergovernmental tax immunity cases, the Court understood the doctrine's bar on discrimination against those doing business with the federal government to rest on a less formalistic principle. It explained that the doctrine is intended to preclude interference with the operations of the federal government by serving as a "safeguard against excessive taxation." *South Carolina* v. *Baker*, 485 U.S. 505, 526 n.15 (1988). And it found that such a safeguard is present when a state tax on those dealing with the federal government also "falls on a significant group of state citizens who can be counted upon to use their votes to keep the State from raising the tax excessively, and thus placing an unfair burden on the Federal Government." *Washington* v. *United States*, 460 U.S. 536, 545 (1983). See Comment, *Federal Immunity from State Taxation: A Reassessment*, 45 U. Chi. L. Rev. 695, 729 (1978).[12]

In the years leading to *Davis* that principle consistently guided the Court's determination whether a state tax is discriminatory. The Court's decision in *United States* v. *County of Fresno*, 429 U.S. at 463-464, is illustrative. There, several California counties had imposed a use tax on possessory interests in improvements on otherwise tax-exempt land. *Id.* at 455. Pursuant to the tax, federal employees were assessed on the fair rental value of the government-owned houses where they resided. Upholding the tax as nondiscriminatory, the Court expressly

[12] That rationale for the doctrine harkened back to its origins in *McCulloch* v. *Maryland*, 17 U.S. (4 Wheat.) 159 (1819). With the famous observation "that the power to tax involves the power to destroy," the Court there explained that

> [t]he only security against the abuse of this power, is found in the structure of the government itself. In imposing a tax, the legislature acts upon its constituents. This is, in general, a sufficient security against erroneous and oppressive taxation.

Id. at 209. See also L. Tribe, *supra*, at 512 (*McCulloch* based on the "principle that a government may not tax or control those whom it does not represent").

distinguished a tax imposed only on the federal government from the California use tax under review:

> A tax on the income of federal employees, or a tax on the possessory interest of federal employees in Government houses, *if imposed only on them*, could be escalated by a State so as to destroy the federal function performed by them either by making the Federal Government unable to hire anyone or by causing the Federal Government to pay prohibitively high salaries. This danger would never arise, however, if the tax is also imposed on the income and property interests *of all other residents and voters of the State*.

Id. at 463 n.11 (emphasis added).

Prior to *Davis*, this principle would have seemed to validate taxes such as those in Michigan and Virginia. Such taxes were assessed against the pensions of all citizens except former state employees, and thus provided an adequate political check on the State's taxing power. In fact, the check in *Davis* was very strong indeed. Of the four and one half million taxpayers in Michigan, only 130,000 were exempted from the tax. *Davis*, 489 U.S. at 821 (Stevens, J., dissenting). The outcome in *Davis* thus was anything but foreordained. See Mueller, *Rejection of the "Similarly Situated Taxpayer" Rationale:* Davis v. Michigan Department of Treasury, 43 Tax Lawyer 431, 441 (Winter 1990) ("The majority in *Davis* rejected a long-standing doctrine").[13]

In holding to the contrary and rejecting the argument that extension of the tax to the vast majority of the State's taxpayers obviated any threat to the federal

[13] The lower courts thus generally have agreed that *Davis* established a new principle of law. See *Duffy* v. *Wetzler*, 579 N.Y.S.2d 684, 691 (N.Y. App. Div.), appeal dismissed, 583 N.Y.S.2d 190 (N.Y. 1992); *Sheehy* v. *Montana*, 820 P.2d 1257, 1260 (Mont. 1991), petition for cert. filed, 60 U.S.L.W. 3675 (U.S. Mar. 9, 1992) (No. 91-1473); *Bass*, *supra*; *Swanson* v. *North Carolina*, *supra*; *Bohn*, *supra*. See also *Swanson* v. *Powers*, 937 F.2d at 968.

government, the *Davis* Court relied entirely on *Phillips*. See 489 U.S. at 815 n.4. While we do not now take issue with the *Davis* Court's reading of that case, there certainly is room to doubt that the language of the *Phillips* opinion put States on notice that statutes such as the one at issue in *Davis* were unconstitutional—a conclusion that is confirmed by the failure of any taxpayer to launch a tax immunity-based challenge to such a statute for almost *three decades* after the *Phillips* decision was handed down.

Phillips involved a state scheme that imposed a more burdensome tax on lessees of federal property than fell on lessees of state property; it appeared that lessees of private tax-exempt property were altogether exempt from tax, although in such a case the value of the leased property became taxable to the lessor at the same rates as applied to lessees of federal property. 361 U.S. at 380-381. The Court noted that when property was leased from private tax-exempt owners "the lessee's *indirect* burden * * * is as heavy as the burden imposed directly on federal lessees" (*id.* at 381 (emphasis added)), and it therefore observed, as the Court subsequently noted in *Davis* (see 489 U.S. at 815 n.4), that "there appears to be no discrimination between the Government's lessees and lessees of private property." 361 U.S. at 381. It also is true, however, as Justice Stevens noted in his *Davis* dissent (see 489 U.S. at 825-826), that the *Phillips* Court's constitutional analysis proceeded to address as the relevant universe of taxpayers only lessees of public (either federal or state) land. See 361 U.S. at 382-383. It is accordingly unclear whether the Court meant to hold it irrelevant that taxpayers who dealt with neither the federal nor the state governments were accorded treatment similar to that felt by federal lessees. Subsequent decisions invalidating state taxes on immunity grounds did not involve levies that fell in substantial part on in-state taxpayers and therefore shed no light on the question. See *Memphis Bank & Trust Co.* v. *Garner*,

459 U.S. 392 (1983); *Moses Lake Homes, Inc.* v. *Grant County*, 365 U.S. 744 (1961).

Given the Court's subsequent emphasis on the political check provided by the extension of a levy to the ordinary run of taxpayers, state officials surely were entitled to presume the constitutionality of statutes such as the one ultimately invalidated in *Davis*. Again, the reaction of the affected parties is telling: until the time of the *Davis* litigation, none of the 23 States with such statutes moved to repeal its tax, and none of the innumerable affected taxpayers sought to challenge such a tax. Against this background, *Davis* established a new rule that had not been meaningfully foreshadowed.

3. The final two prongs of *Chevron Oil* also favor purely prospective application of *Davis*. The policies of the intergovernmental tax immunity doctrine plainly are not advanced by retroactivity. This Court has made it plain that the essential purpose of the doctrine is to protect the interests of the federal government and not, as petitioners suggest (Pet. Br. 32), to advance the personal interests of that government's employees:

> [T]he purpose of the immunity was not to confer benefits on the employees by relieving them from contributing their share of the financial support of the other government * * * but to prevent undue interference with the one government by imposing on it the tax burdens of the other.

Graves v. *New York ex rel. O'Keefe*, 306 U.S. 466, 483-484 (1939). See *Davis*, 489 U.S. at 814 ("[I]ntergovernmental tax immunity is based on the need to protect each sovereign's governmental operations from undue interference by the other."). A refund would serve only petitioners' interests, not those of the federal government—a conclusion that draws support from the federal government's participation in *Davis*, but not in this case, in support of the taxpayer. Similarly, of course, "[t]he imposition of liability in hindsight against a State that, acting reasonably would do the same thing again, will

prevent no unconstitutionality." *Beam*, 111 S. Ct. at 2455 (O'Connor, J., dissenting). See also Fallon & Meltzer, *supra*, at 1804.

The third prong of *Chevron Oil* is also clearly satisfied. As described above, retroactive application will "produce substantial inequitable results," 404 U.S. at 107, not only for Virginia but for many other States as well. And the windfall to petitioners would be manifest. In these circumstances, the Court should deny *Davis* retroactive effect.

CONCLUSION

The judgment of the Virginia Supreme Court should be affirmed.

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HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

BRIEF *AMICI CURIAE* BY THE STATES OF NORTH CAROLINA AND ARIZONA IN SUPPORT OF THE VIRGINIA DEPARTMENT OF TAXATION

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No. 91-794

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1992

HENRY HARPER, *et al.*,
Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,
Respondent.

On Writ of Certiorari to the Supreme Court of Virginia

**Brief *Amici Curiae* by the
States of North Carolina and Arizona
In Support of the Virginia Department of Taxation**

INTEREST OF AMICI CURIAE

North Carolina has a direct interest in the outcome of this case because it has pending before this Court a case raising the same principal question -- the prospectivity or retroactivity of this Court's decision in *Davis v. Michigan Department of Treasury*, 489 U.S. 803 (1989) ("*Davis*"). *Swanson v. North Carolina*, 329 N.C. 576, 407 S.E.2d 791 ("*Swanson I*"), *adhered to on reh'g*, 330 N.C. 390, 410 S.E.2d 490 (1991) ("*Swanson II*"), *pet. for cert. pending*, No. 91-1436. Arizona also has a direct interest because a case raising the same question is presently before the Arizona Court of Appeals. *Bohn v. Waddell*, 164 Ariz. 74, 790 P.2d 772 (Ariz. Tax 1990), *aff'd on reconsideration*, 167 Ariz. 344, 807 P.2d 1 (Ariz. Tax 1991), *appeal pending*, No. 1 CA-

TX 90-029 (Ariz. App.). In these cases, North Carolina and Arizona have estimated potential liability for refunds amounting to approximately one-half billion dollars. Thus, as *amici curiae*, North Carolina and Arizona have compelling interests in the outcome of this case and can illustrate to the Court the profound impact its decision may have on other states and their citizens and taxpayers.

SUMMARY OF ARGUMENT

Virginia, North Carolina, Arizona and other states affected by this Court's decision in *Davis* should not be compelled to pay crippling refunds of pre-*Davis* income taxes. The Court must leave room in the law for consideration of the devastating impact a law-changing decision can have when the Court overrules precedent upon which states have relied or when the Court announces a new rule of law in a case of first impression whose resolution was not clearly foreshadowed.

For many decades before *Davis*, North Carolina, Arizona, and twenty-one other states, without challenge, had exempted the retirement benefits of their retired public servants from income tax to account, in part, for the generally low wages paid to them while working and to encourage public servants to stay in the public's service so that all their citizens could benefit from an experienced public work force. Federal retirees generally received no exemptions or smaller ones. These differences in taxation, though founded on sound, rational public policies, were abandoned following *Davis*, and federal retirees throughout these states thereby effectively received prospective relief. These federal retirees, who had paid taxes on their retirement benefits without challenge for decades, now seek retroactive relief in the form of tax refunds amounting in Virginia, North Carolina and Arizona alone to approximately one

billion dollars. Imposing staggering refund burdens on the affected states -- which had in good faith relied on longstanding, rational and presumptively valid state laws -- would force them to increase the tax burdens on their citizens or cut vital services to citizens at a time when many states are facing grave fiscal crises. The law cannot require such an inequitable result. Equity may in fact be achieved by either of two means.

First, the Court can achieve equity by keeping the prerogative to apply law-changing decisions prospectively when reasonable reliance and the harmful consequences of retroactivity make retroactive application unjust. The analysis prescribed in *Chevron Oil Co. v. Huson*, 404 U.S. 97 (1971) ("*Chevron Oil*"), should be retained to determine whether to apply prospectively a decision which unexpectedly changes the landscape of the law. It provides a logical and rational means by which states' concerns can be addressed by considering the equities of those directly affected by law-changing decisions and allowing prospective-only application of those extraordinary decisions which will have a devastating impact on states which reasonably relied on pre-existing law. Application of the *Chevron Oil* analysis to *Davis* leads inexorably to the conclusion that *Davis* should not be applied retroactively.

The decision in *James B. Beam Distilling Co. v. Georgia*, ___ U.S. ___, 111 S. Ct. 2439 (1991) ("*Beam*"), does not preclude prospective-only application of *Davis*. In *Davis*, Michigan's concession that it would give Mr. Davis a refund if its tax statute was held unconstitutional obviated the need for the Court to consider the retroactivity issue. Thus, principles of *stare decisis* were not implicated. Under *Beam*, a decision ordinarily is presumed to apply retroactively unless the Court indicates otherwise. However, this presumption does not arise

when the issue has been eliminated as part of the case. To apply the presumption and give *stare decisis* effect to a matter that the Court did not even implicitly consider would result in constitutional adjudication through inadvertence or accident. To apply *Davis* retroactively based on Michigan's concession would result in inflicting liability on all states based upon a concession other states would not have made, if given the choice, and which they had no opportunity to influence.

Alternatively, if the *Chevron Oil* analysis is not applied to give *Davis* prospective-only effect, then states should be allowed to refuse refunds of pre-*Davis* taxes as a matter of remedies law. As *Beam* recognized, the states' reliance interests are entitled to consideration in determining the remedy that must be provided for taxes collected pursuant to a statute later held unconstitutional. The Court should make clear that in some cases retroactive decrees, that could seriously undermine the states' financial stability by imposition of unforeseeable after-the-fact liability of mammoth proportions, would be so inequitable that a law-changing decision simply should not be applied retroactively as a matter of remedies law.

This Court should dispel any confusion as to a state's authority -- as either a choice of law or remedial matter -- to deny refunds to federal retirees in the wake of *Davis* by affirming the *Harper* decision.

ARGUMENT

THE STATES SHOULD NOT BE COMPELLED TO PAY REFUNDS OF PRE-*DAVIS* INCOME TAXES TO FEDERAL RETIREES.

Introduction

In 1989, this Court held unconstitutional Michigan's imposition of income tax on the retirement benefits of federal civil service retirees while exempting the retirement benefits of state and local government retirees. *Davis,* 489 U.S. 803. The *Davis* decision unleashed a flood of litigation challenging similar provisions in twenty-three states, including Virginia, North Carolina and Arizona. Now the Court must grapple with the troubling question whether *Davis* requires those states to pay staggering tax refunds to federal retirees. Resolution of this question will have profound consequences for the states affected by *Davis* and for the future.

The potential liability of all the states was initially estimated at $2.2 billion. *See* W. Hellerstein, Preliminary Reflections on *McKesson* and *American Trucking Associations*, 48 Tax Notes No. 3, 325, 326 (July 16, 1990). Virginia's potential liability is now estimated to be $467,000,000.00. North Carolina faces potential liability for refunds estimated in 1989 to be at least $140,000,000.00, exclusive of interest. Arizona's potential liability was estimated to be $261,000,000.00 at the time of the Arizona Tax Court proceedings and is now estimated to be $339,000,000.00 with accruing interest if full refunds are required. However, the Tax Court has ordered refunds using a partial refund formula whereby Arizona's liability would be substantially reduced. Thus, the potential liability of Virginia,

North Carolina, and Arizona alone approaches the staggering sum of a billion dollars.

The Court must consider the devastating impact that refunds to federal retirees would have on the citizens of the affected states. Room must be left in the law for a balancing of equities in those extraordinary situations where, as here, retroactive application of decisions changing the landscape of the law will harshly and unjustly require the redistribution of billions of dollars of the public's money to a relatively few citizens to the detriment of the public as a whole. The Court should uphold the states' denial of retroactive relief to federal retirees based either on choice of law principles or the flexibility inherent in the law of remedies. Whichever theory or doctrinal framework the Court applies, recognition must be given to the inherent inequity to states and their citizens of compelling crippling tax refunds in the aftermath of *Davis* and other decisions which burst upon the horizons of state tax law and upset decades of settled understandings and expectations.

I. THE EQUITABLE INTERESTS OF THE STATES AND THEIR CITIZENS GREATLY OUTWEIGH ANY EQUITABLE CLAIMS OF FEDERAL RETIREES TO *DAVIS* REFUNDS.

The equitable interests of all the citizens of the states engulfed by the *Davis* litigation outweigh the claims of federal retirees for refunds of pre-*Davis* taxes. Years of reliance on rational, presumptively valid statutes, prompt action by states to conform their tax structures to the *Davis* holding, longstanding failure of federal retirees to challenge their tax obligations, and the extreme hardships to states and their citizens which would result from a decision requiring refunds to federal retirees all combine to make refunds harsh and unjust. The extraordinary

harm which would be visited upon the states and their citizens requires that the Court recognize the equitable interests of the states and their citizens as an essential component of its decision in this case. The harsh and unjust consequences of requiring refunds are vividly illustrated by the circumstances in North Carolina and Arizona.

A. State Tax Policies Before *Davis* Stemmed From Rational and Non-Invidious Legislative Choices.

The decision by states many decades ago[1] to exempt fully the retirement benefits of retired state and local government employees had two rational and legitimate purposes: (1) to enhance the benefits of retired employees to offset, in part, the generally low salaries they received while working; and (2) to provide current employees with an incentive to remain in public service and thereby provide all citizens with an experienced work-force to meet their needs. These policies did not "discriminate"

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[1] The North Carolina Local Governmental Employees' Retirement System was created some fifty years ago in 1939 with an income tax exemption for retirement benefits. 1939 N.C. Sess. Laws c. 390, s. 11. The Teachers' and State Employees' Retirement System of North Carolina, created in 1941, also included from its inception an income tax exemption for retiree benefits. 1941 N.C. Sess. Laws c. 25, s. 9. In Arizona, the exemption was in place for thirty-six years. Arizona Code 1939, Supp. 1953, § 12-858; *See also Bohn v. Waddell*, 164 Ariz. at 85, 790 P.2d at 783 (minimum of twenty-five years). Other states' exemptions had also been in place for many years. *See, e.g., Harper v. Virginia Dept. of Taxation*, 241 Va. 232, ___, 401 S.E.2d 868, 871 (1991) ("*Harper I*"), *reaff'd on remand*, 242 Va. 322, 410 S.E.2d 629 (1991) ("*Harper II*") ("almost half a century"); *Bass v. South Carolina*, 302 S.C. 250, 256, 395 S.E.2d 171, 174 (1990) ("*Bass I*"), *reaff'd on remand*, ___ S.C. ___, 414 S.E.2d 110 (1992), *pet. for cert. pending*, No. 91-1697 ("*Bass II*") (since 1945); *Duffy v. Wetzler*, 579 N.Y.S.2d 684, 686, 174 A.D.2d 253, 256 (App. Div. 1992), *app. dismissed*, 79 N.Y.2d 976, 583 N.Y.S.2d 190 (Apr. 7, 1992) (since 1920).

against federal retirees or constitute a "threat" to the federal government in the usual sense of those words. North Carolina exempted $3,000 of the benefits of federal retirees from state income taxes. N.C. Gen. Stat. § 105-141(b)(18) (1973). Arizona exempted $2,500 of federal civil service benefits, 1962 Ariz. Sess. Laws c. 24, s. 43-112(25), but gave no exemption for military retirement benefits. Other than state and local government retirees, federal retirees were the only retirees who received the benefit of an exemption. The federal retiree exemption, like the exemption for state and local retirees, served as an incentive for federal employees to remain in federal service so that all citizens could benefit from experienced federal employees.

Following *Davis*, North Carolina and Arizona repealed the full exemption for the retirement benefits of state and local retirees and adopted a partial exemption for local, state and federal government retirees alike.[2] Now federal retirees, who previously benefited from North Carolina's and Arizona's efforts to secure experienced work forces at both the state and federal level for the benefits of their citizens, seek to have all of the 11 million citizens of these two states suffer an increase in taxes or loss of public services so that federal retirees may receive refunds

[2] North Carolina adopted a $4,000 exemption, and Arizona adopted a $2,500 exemption for local, state and federal government retirees alike. The group who suffered most from this change in the law were the state and local government retirees, who are now required to pay taxes on their benefits despite years of reliance on the full exemption of their benefits from taxation. The value of this lost benefit to retired state and local government employees is estimated to be as much as $50,000,000.00 per year in North Carolina. However, state and local government retirees' challenge to the drastic reduction of their tax exemption was rejected by the North Carolina Supreme Court. *Bailey v. North Carolina*, 330 N.C. 227, 412 S.E.2d 295 (1991), *cert. denied*, ____ U.S. ____, 112 S. Ct. 1942 (1992).

of almost a half billion dollars. The Court's decision in this case may effectively determine whether Virginia, North Carolina, Arizona and other states will be forced to pay out massive sums of money at the direct expense of their other citizens and taxpayers at a time when many states are struggling with severe revenue shortages.[3]

B. Requiring Refunds Would Impose a Crushing Burden on the Affected States and Their Citizens.

During many decades in which state and local retirees paid no income taxes on their retirement benefits, state legislators and executive officials made hard choices year after year about what taxes to impose and in what amounts, about what services to fund and in what amounts, and about how to balance the state revenues and expenses as required by some state constitutions. *E.g.*, Ariz. Const. art. IX § 5; N.C. Const. art. III § 5(3). They necessarily counted on and expended the income taxes paid by federal retirees and all other citizens. All that money has now been spent for the public good, including, for example, the education of the children and grandchildren of federal retirees. None of that money will magically reappear in the states' proverbial deep pockets.

If *Davis* requires refunds to federal retirees, the states must either increase taxes or slash services, or choose some

[3] Of course, states may still have valid procedural or other defenses to federal retirees' refund claims. *See, e.g., Swanson v. North Carolina*, No. 91-1436, Brief in Opposition to Petition for Writ of Certiorari to the Supreme Court of North Carolina, at 18-20.

combination of the two.[4] Higher taxes will be borne by taxpayers who are struggling to cope during these difficult financial times. Working people, private pensioners, and retired people without pensions, who provided for their retirement as best they could through savings and investments, have already paid taxes on their earnings and pensions for past years. Refunds to federal retirees would extract additional taxes from these people, many of whom are less well off than the federal retirees and who paid at least as much tax as the federal retirees. Ironically, even the federal retirees themselves will have to pay greater taxes to fund their pro rata shares of their own refunds.

If the states choose instead to reduce services, the costs of the refunds will be shifted to troubled educational systems, overcrowded correctional systems, children in needy families, and everyone who benefits from the vast array of services provided by state governments, including the federal retirees. Those who are the poorest and the most politically impotent are most in need and, in the imperfect world in which we live, may suffer most. However, no citizen would be immune from the impact. All citizens suffer, and future generations will suffer, when the states' major governmental functions cannot be performed effectively because of insufficient resources, whether through inadequate education, or inadequate attention to the environment, the public health, the labor force, or the criminal justice system.

[4] This Court, and Mr. Harper in his brief, have suggested that in theory the states might limit the specter of monumental refund claims by collecting income taxes retroactively from state and local retirees who previously enjoyed the exemption. The extent to which retroactive taxation is permissible under the Due Process Clause of the Constitution is uncertain, at best. *See McKesson Corp. v. Florida Alcohol and Tobacco Div.*, 496 U.S. 18, 40 n.23 (1990) ("*McKesson*"); *American Trucking Ass'ns, Inc. v. Smith*, 496 U.S. 167, 181 (1990) ("*ATA*"). For North Carolina, an even greater barrier to retroactive taxation is found in the state constitution, which prohibits "laws taxing retrospectively sales, purchases, or other acts previously done. . . ." N.C. Const. art. I § 16. Moreover, retroactively taxing the benefits of innocent retired state and local government employees in order to "cure" the "discrimination" against retired federal employees is hardly a palatable legislative choice.

For North Carolina and Arizona, the stakes are high. Refunding almost a half billion dollars to federal retirees would cripple their ability to meet the needs of their citizens. For example, with regard to North Carolina, $140,000,000.00 is more than the current annual appropriations by the General Assembly to operate both the Department of Labor, which administers the Occupational Safety and Health Act and the state's minimum wages laws, and the Division of Social Services, which administers numerous programs to aid needy, neglected and abused adults and children. It approximates the annual appropriation to the Department of Environment, Health and Natural Resources, which administers all the state's environmental protection programs, and is 70% of the annual appropriation for operation of the state's entire judicial system. 1991 N.C. Sess. Laws c. 689, s. 3. $140,000,000.00 would add approximately 5,000 teachers to the beleaguered public school system. $140,000,000.00 is more than enough money to build at least four new prisons to house over 3,000 additional prisoners, thereby reducing the revolving door phenomenon caused by severe overcrowding. The detrimental effect on the State of North Carolina of paying out that amount of money, totally above and beyond funding its normal operations, cannot be overstated.

For Arizona, the potential refund of $339,000,000.00 is 9.2 percent of the State's Fiscal Year 1993 budget of $3,668,276,400.00. $339,000,000.00 is about one third of the appropriation for the total Health and Welfare services of the state. This amount is roughly equivalent to the $328,715,400.00

projected costs of the Protection and Safety budget for Arizona to be appropriated from the General Fund. $339,000,000.00 is more than half of the appropriation for Arizona's court system and universities combined.

States in which the specter of mammoth *Davis* refunds looms over the budget horizon should not be forced to make such "no-win" choices at a time when they are already juggling severe revenue shortages with their citizenries' most critical needs. *Davis* came at a time when North Carolina was "in dire financial straits," *Swanson I*, 329 N.C. at 583, 407 S.E.2d at 794, and the enormous refund claims by Arizona's federal retirees would "endanger" the state's "financial integrity," *Bohn*, 164 Ariz. at 91, 790 P.2d at 789.[5] North Carolina, in fact, recently faced its most severe budget crisis since the Great Depression. The recession, decreases in federal funding, and other factors combined to create a billion dollar gap between revenues and the needs of citizens. Drastic actions were required. The Governor reduced budgeted appropriations to agencies and imposed hiring freezes. Exec. Order No. 114 (8 May 1990); Exec. Order No. 130 (9 Jan. 1991). The General Assembly enacted the largest tax increase in the state's history. 1991 N.C. Sess. Laws c. 689, ss. 249-338. Despite these actions, many programs and services, such as the State's public university system, continue to suffer from inadequate funding. *See generally* Fiscal Realities for the

[5] This is also the case in other states. In South Carolina, refund of the "exorbitant amount" of $200,000,000.00 "would impose a severe financial burden on the State and its citizens as well as endanger the financial integrity of the State." *Bass I*, 302 S.C. 256, 395 S.E.2d at 174. The $467,000,000.00 sought by Virginia's federal retirees "would come at a time when the Commonwealth is already struggling to meet enormous fiscal deficits" and "would have a potentially disruptive and destructive impact on the Commonwealth's planning, budgeting, and delivery of essential state services." *Harper I*, 401 S.E.2d at 873.

90's: Report of the [North Carolina] Economic Future Study Commission (March 1991); State Treasurer's Annual Report: Fiscal Year 1990/1991; State of the State Address/Biennial Budget Message, 1991 N.C. Sen. J. pp. 1408 *et seq.*

Similarly, Arizona has faced perennial budget crises since the mid-1980's. These crises resulted in the adoption of the 1990 Arizona Individual Income Tax Reform Act. 1990 Ariz. Sess. Laws c. 3 (3rd Special Session). This new law increased income taxes on the average by 17.5% and, through June, 1991, resulted in $123 million of additional revenues.[6] Report Fiscal Services and Analysis Div., Results of the 1990 Arizona Individual Income Tax Reform, Arizona Dept. of Rev., July, 1991.

Crushing financial burdens are undeniably relevant to any judicial determination whether states must make payments or refunds for actions taken under statutes not previously suspected to be unconstitutional. This Court has taken them into account and should continue to do so: "Imposing such unanticipated financial burdens would come at a time when many States and local governments are struggling to meet substantial fiscal deficits." *Arizona Governing Comm. v. Norris*, 463 U.S. 1073, 1106-07 (1983) (Powell, J.). The Court has recognized the inequities of requiring refunds of newly-invalidated taxes which

[6] Because of a decrease in the "age 65 and over" exemption and a higher threshhold for deducting medical expenses, the average increase to age 65 and older citizens was even greater than the overall average increase of 17.5%. Therefore, the Arizona Legislature enacted a minor income tax decrease by increasing this exemption and lowering the medical expense deduction threshhold. 1992 Ariz. Sess. Laws c. 290 (2nd Regular Session); 1992 Ariz. Sess. Laws c. 7 (4th Special Session).

"could deplete the state treasury, thus threatening the State's current operations and future plans." *ATA*, 496 U.S. at 182. Requiring the monumental refunds at issue because of *Davis* "injures all of the [states'] constituents," *id.* at 185, including the federal retirees; state and local government retirees, who relied on long-standing, but now withdrawn, exemptions; and all other taxpayers, working people and retired, who generally had no such exemptions. This Court need not wreak such havoc upon the states and their citizens.

C. Fundamental Fairness Does Not Require the Payment of Refunds to Federal Retirees.

Federal retirees did not pay excessive taxes in comparison to all the other taxpayers in North Carolina and Arizona. Indeed, with the exception of federal military retirees in Arizona, they paid less than their fair share of taxes in relation to all taxpayers except state and local government retirees. The only "injury" they "suffered" was the result of a rational and logical decision of each state to build an experienced workforce of public servants, and to extend to state retirees what appeared simply to be an employment benefit for its own employees, rather than an attempt to discriminate against federal retirees. The federal retirees' "injury," such as it was, resulted not from the denial of an individual constitutional right, but from the violation of a rule designed to protect the federal government from interference with its operations.

For decade after decade, federal retirees paid income taxes on their retirement benefits virtually without challenge.[7]

[7] An equal protection challenge to Arkansas' exemption of state and local retirees was rejected in *Streight v. Ragland*, 280 Ark. 206, 655 S.W.2d 459 (1983). There were no other reported decisions adjudicating direct challenges to such exemptions until *Davis* itself.

Even in states like Virginia and Arizona, where no prepayment of taxes was required, federal retirees did not challenge the constitutionality of such taxation. Hundreds of thousands of federal retirees, who never saw any unconstitutional burden in the taxes they paid until after *Davis* was decided, and who made no efforts to assert constitutional challenges, should not now be allowed to collect a windfall of hundreds of millions of dollars at the expense of all the citizens of their respective states.

The widespread, longstanding and virtually unchallenged existence of state retirees' income tax exemptions cannot be ignored when the Court contemplates the enormous refund claims now facing many of the nation's sovereign states. "The actual existence of a statute, prior to . . . a determination [that the statute is unconstitutional], is an operative fact and may have consequences which cannot justly be ignored. The past cannot always be erased by a new judicial declaration." *Chicot Co. Drainage Dist. v. Baxter State Bank*, 308 U.S. 371, 374 (1940).

Indeed, "absent contrary direction, state officials and those with whom they deal are entitled to rely on a presumptively valid state statute, enacted in good faith and by no means plainly unlawful." *Lemon v. Kurtzman*, 411 U.S. 192, 208-09 (1973) ("*Lemon II*"). In *Lemon II*, the Court rejected the idea that state officials should be required to await adjudication of the constitutionality of newly-enacted state laws or risk having their actions and arrangements unravelled in "draconian, retrospective decrees." *See* 411 U.S. at 207. Here, the federal retirees who have sued the respective states threatened by *Davis*'s progeny should not be able to compel the unravelling of the states' hard budgeting and financial decisions by obtaining draconian

retrospective refund decrees. Those states relied on the presumptive validity not of newly-enacted statutes, but of tax measures adopted and implemented decades before and administered for many years without challenge. *Davis* cannot impose such a harsh penalty on the citizens of the states faced with federal retirees' refund claims.[8]

It is not unfair to the federal retirees to deny them refunds for which they made no constitutional claims and which they had no reason to expect until *Davis* was decided. This is especially true when the stakes are so high and the alternatives so destructive to state budgets and the provision of services to citizens. The Court's constitutional adjudication must leave room for addressing the impact of its decisions when it promulgates unanticipated constitutional rulings. Otherwise, the states' budgets can be wrecked overnight by decisions of which they had no forewarning. The Court can choose among different approaches, two of which are discussed here, to avoid these unjust and destructive results. But, the Court cannot avoid either selecting a jurisprudential theory which addresses these essential

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[8] Contrary to assertions made by the federal retirees, there is nothing abberant about denying them retroactive monetary relief for violation of their rights. Retroactive monetary relief is typically not available against the states and their officials. Principles of sovereign immunity embodied in the Eleventh Amendment, *Pennhurst State School and Hospital v. Halderman*, 465 U.S. 89 (1984), and important principles of public policy embodied in the rule of qualified immunity, *Harlow v. Fitzgerald*, 457 U.S. 800, 819 (1982), often preclude retroactive monetary relief from the states and their officials for violation of federal constitutional or statutory rights. In fact, the Eleventh Amendment and qualified immunity proved a bar to efforts of North Carolina's federal retirees to obtain refunds in federal court. *Swanson v. Powers*, 937 F.2d 965 (4th Cir. 1991), *cert. denied*, ___ U.S. ___, 112 S. Ct. 871 (1992). Qualified immunity also precluded Arizona's federal retirees from obtaining damages from individual taxing officials under 42 U.S.C. § 1983 in *Bohn v. Waddell*, 164 Ariz. at 86, 790 P.2d at 784.

issues or leaving the states and their citizens at the mercy of the vicissitudes of constitutional decisionmaking.

II. *DAVIS v. MICHIGAN DEPARTMENT OF TREASURY* SHOULD BE APPLIED PROSPECTIVELY UNDER A *CHEVRON OIL v. HUSON* ANALYSIS.

This Court has repeatedly held that courts may apply law-changing decisions prospectively when the harmful consequences of retroactivity and reasonable reliance interests make retroactivity unjust. In *Chevron Oil*, 404 U.S. 97, the Court set out a three-pronged test for determining whether a law-changing decision should be applied retroactively or prospectively. *See also, e.g., Florida v. Long*, 487 U.S. 223, 230 (1988); *Northern Pipeline Construction Co. v. Marathon Pipe Line Co.*, 458 U.S. 50, 87-88 (1982). The *Chevron Oil* analysis ably facilitates the Court's consideration of exactly the factors which argue against allowing unexpected and unforeseeable decisions to "unfairly surprise" state governments, their financial stability, and their citizens by suddenly imposing devastating after-the-fact liabilities. It provides a logical and rational means by which states' concerns can be addressed by considering the equities of those directly affected by a law-changing opinion and allowing prospective-only application of decisions which will have a devastating impact on those who reasonably relied on the law as it was before the law-changing decision.

The *Chevron Oil* analysis should be retained and applied to the post-*Davis* decisions because it is "settled law" which the Court "should stick to . . . absent some compelling reason to discard it." *Lee v. Weisman*, ___ U.S. ___, 112 S. Ct. 2649, 2668 (1992) (Souter, J., concurring). There is no such compelling reason for discarding it. To the contrary, the *Chevron Oil* analysis "is subject to a kind of reliance that would

lend a special hardship to the consequences of overruling and add inequity to the cost of repudiation." *Planned Parenthood of Southeastern Pennsylvania v. Casey*, ___ U.S. ___, 112 S. Ct. 2791, 2808 (1992). The Court should continue to employ the *Chevron Oil* analysis to determine when a case merits prospective application. The Supreme Courts of Virginia, North Carolina, South Carolina, and Montana, have considered *Davis* to be such a case.[9]

A. *Davis* Was Not Clearly Foreshadowed.

Davis was a case of first impression whose resolution was not clearly foreshadowed.[10] It fundamentally altered the purpose and scope of the doctrine of intergovernmental tax immunity.[11]

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[9] *Harper I*, 241 Va. 232, 401 S.E.2d 868, *reaff'd on remand*, *Harper II*, 242 Va. 322, 410 S.E.2d 629; *Bass I*, 302 S.C. 250, 395 S.E.2d 171, *reaff'd on remand*, *Bass II*, 414 S.E.2d 110; *Swanson I*, 329 N.C. 576, 407 S.E.2d 791, *adhered to on reconsideration*, *Swanson II*, 330 N.C. 390, 410 S.E.2d 490; *Sheehy v. Montana*, 250 Mont. 541, 820 P.2d 1257 (1991), *pet. for cert. pending*, No. 91-1473.

[10] The fact that *Davis* relied on earlier cases as precedent for its holding is no indication that its result was clearly foreshadowed. Hindsight may illuminate a pattern which cannot be identified beforehand. Precedent can be cited to support even the most revolutionary decisions. The Court has recognized that a rule may be a new one even though the Court is able to cite precedent to support it. "Courts frequently view their decisions as being 'controlled' or 'governed' by prior opinions even when aware of reasonable contrary conclusions reached by other courts." *Butler v. McKellar*, 494 U.S. 407, 415 (1990).

[11] Petitioners argue that *Davis* was not a law-changing decision because it did not overrule any earlier decision by this Court. By petitioners' reasoning, if a rule of law has been so generally understood to be correct that no one has ever challenged it (which was actually the case with the pre-*Davis* understanding of the intergovernmental tax immunity doctrine), a decision overturning it by definition would not declare new law and would not be eligible for prospectivity analysis, while a decision finally rejecting a precedent repeatedly assailed and

The purpose of the intergovernmental tax immunity doctrine, prior to *Davis*, was to protect the state and federal governments from undue interference by the other. *Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 485-86 (1939). Before *Davis*, the states did not expect statutes to be invalidated under the intergovernmental tax immunity doctrine unless they were either aimed at or threatened the operation of the federal government. The immunity served as a political check against the abuse of taxing power when a state imposed a tax on a federal entity. *See United States v. County of Fresno*, 429 U.S. 452 (1977). As Justice Stevens pointed out in his dissent in *Davis*, since the "burden" on federal retirees was shared by many other state citizens, the political check of those citizens' opposition to excessive taxation could legitimately have been viewed as sufficient protection for the federal government from undue interference with its operations through state taxation. 489 U.S. at 820. *See also Washington v. United States*, 460 U.S. 536, 545 (1983). The income tax exemption of state retiree benefits and the taxation of all other retirement benefits is not a tax system aimed at the operation of the federal government or threatening its operation. If the income tax exemptions for state and local government employees had posed a threat to it, surely the federal government itself would have discovered the "threat" and raised the issue itself over the longstanding history of such exemptions. In fact, as compared with its treatment of private pensions, North

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repeatedly upheld only by one-Justice majorities would declare new law and might be eligible for prospectivity analysis. Petitioners' argument is contrary both to logic and to the settled principle – dating back at least to James Madison – that legislators may rely on uninterrupted practice under a statute for the statute's proper interpretation. *See* 4 Letters and Other Writings of James Madison 183-187 (Cong. ed. 1865) (letter discussing the "necessity of regarding a course of practice as . . . a legal rule" or precedent that legislators ought to follow in "interpreting a law").

Carolina's and Arizona's systems benefited federal retirees and thereby enhanced the operation of the federal government by giving all federal employees in North Carolina, and federal civil service employees in Arizona, an incentive to remain in the federal service.

That *Davis* was not clearly foreshadowed by the prevailing understanding of the doctrine of intergovernmental tax immunity or any accepted view of 4 U.S.C. § 111 is illustrated by the discussion in *Swanson v. Powers*, in which the Fourth Circuit Court of Appeals held that North Carolina's Secretary of Revenue was entitled to qualified immunity against the *Swanson* plaintiffs' claims that she violated their rights by enforcing North Carolina's pre-*Davis* income tax laws. The court noted that modern intergovernmental tax immunity cases generally upheld the taxes challenged in those cases and rested on a rationale that "might have suggested a different result in" *Davis*. 937 F.2d at 970. Reviewing various cases that had distinguished between retirees and employees, the court rejected the notion that Secretary Powers could not have reasonably concluded that 4 U.S.C. § 111 applied only to employees, not to retirees. Consequently, "how the intergovernmental tax immunity doctrine and 4 U.S.C. § 111 applied to North Carolina's revenue statutes was anything but clearly established," 937 F.2d at 971, and equally was anything but clearly foreshadowed.

Davis certainly was not clearly foreshadowed in the eyes of federal retirees and their attorneys,[12] or they would not have

[12] Petitioners repeatedly argue that *Davis* must have been predictable because the *Davis* Court itself relied on a "plain language" interpretation of 4 U.S.C. § 111. This argument is circular -- it amounts to the claim that the holding in *Davis* was foreshadowed because the types of argument used in *Davis* were familiar ones. That it is possible to read § 111 in good faith and come to a different interpretation from that of the *Davis* Court is proven beyond cavil by the fact that Justice Stevens vigorously dissented in that case. *See also* the concurring opinion of Justice Stevens, in which Justice Thomas joined, in *Barker v. Kansas*, ___ U.S. ___, 112 S. Ct. 1619 (1992).

waited so long to challenge the state retirees' exemptions under the intergovernmental tax immunity doctrine and 4 U.S.C. § 111.[13] If *Davis* had been clearly foreshadowed by the Court's earlier decisions, twenty-three states would not have exposed themselves to the devastating levels of potential liability currently staring them in the face. Most of the states could have achieved virtually the same result, but without the risk, by repealing the tax exemptions for state retirees' benefits and providing them a corresponding benefit increase.[14] That they did not demonstrates that the result in *Davis* was not clearly foreshadowed in the view of the twenty-three states whose tax structures are implicated by *Davis*. *Davis* thus satisfies the first prong of the *Chevron Oil* test.

[13] Efforts by federal retirees to challenge their income tax treatment through legislative action or complaints outside the judicial system cannot, of course, legally foreshadow the Court's ruling in *Davis* as a matter of intergovernmental tax immunity. *See Swanson v. Powers*, 937 F.2d at 968.

[14] Indeed, the states have generally chosen to comply prospectively with *Davis* by eliminating or reducing the state and local retirees' exemptions. *See*, *Davis v. Michigan Department of Treasury: One Year Later*, Federation of Tax Administrators (1990), pp. 1-2, 12. However, this option may not have been feasible in some states; for example, New York's exemption of state and local government pensions from state income taxes is lodged in the state constitution. N.Y. Const. art. XVI § 5.

B. The Purpose of the Intergovernmental Tax Immunity Doctrine and 4 U.S.C. § 111 Would Not be Served by Retroactive Application of *Davis*.

It is equally clear that the purpose and effect of the intergovernmental tax immunity doctrine and 4 U.S.C. § 111, and consequently of the *Davis* holding, will not be furthered by applying *Davis* retroactively or retarded by applying it prospectively. The states affected by *Davis* have generally responded by prompt adjustment of their tax structures to equalize taxes between federal and state retirees. None of the states had any intent or purpose to harm the federal government or its operations. They had no inkling beforehand that their exemption of state retirees' benefits would be unconstitutional unless coupled with an identical exemption for federal retirees' benefits. Indeed, state retirees' tax exemptions are best characterized as employment benefits for state and local government employees, not primarily as tax measures. Thus, the principal North Carolina and Arizona exemptions were contained in the states' retirement plan statutes, not in their income tax laws. *E.g.*, N.C. Gen. Stat. §§ 128-31; 135-9 (1986); former A.R.S. §§ 38-762(A) and 38-781.22(A). Retroactive liability cannot serve to deter future violations of the intergovernmental tax immunity doctrine or 4 U.S.C. § 111, or encourage future compliance, when the original violation was the product of a reasonable and rational employment benefit when enacted, and the unintentional discrimination was promptly corrected after the Court declared the state exemptions to be unconstitutional.

The tax exemptions for state and local retirees were to all appearances legitimate employment benefits separate and apart from the seemingly wholly legitimate income taxes imposed on all

other citizens, including federal retirees. "[I]t is not the purpose of the [intergovernmental tax immunity doctrine] to prevent legitimate state taxation," *ATA*, 496 U.S. at 181, and the taxation of federal retirees' benefits was legitimate state taxation for decades, insofar as it was possible to discern from judicial precedent or widespread and longstanding practice. Thus, the purposes of *Davis* and of 4 U.S.C. § 111 would not be furthered by retroactive application of *Davis*.

C. It Would Not Be Equitable to Apply *Davis* Retroactively.

Lastly, under *Chevron Oil*, the Court must assess the equities of retroactive application of *Davis*. As argued above, on every scale the equities plainly lie with the states and all their citizens, not with the federal retirees' refund claims. In contrast to Florida's position in *McKesson*, the twenty-three states with tax exemptions for state and local government retirees were undeniably and legitimately surprised by the ruling in *Davis*. *See McKesson*, 496 U.S. at 50. Their legitimate reliance interests are entitled to recognition through a prospective application of *Davis* in view of the utter unforeseeability of its holding in light of past practice and precedent. *See ATA*, 496 U.S. at 182-83. Evaluation of the *Chevron Oil* factors inexorably leads to the conclusion that *Davis* should not be applied retroactively.

D. This Court's Decision in *Beam* Does Not Require a Different Result.

Beam held only that "when the Court has applied a rule of law to the litigants in one case it must do so with respect to all others not barred by procedural requirements or res judicata." 111 S. Ct. at 2448. This rule is based on "principles of equality and *stare decisis*. . . ." *Id.* at 111 S. Ct. 2446. Neither of those

concepts requires retroactive application of *Davis*. *Beam* dealt with the retroactivity of the Court's decision in *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263 (1984) ("*Bacchus*"). In *Bacchus*, however, the question of retroactive or prospective application of the Court's holding was argued to the Court. *Beam*, 111 S. Ct. at 2445 n.2. When the Court remanded *Bacchus* for consideration of remedial issues, it had necessarily applied its holding to the *Bacchus* litigants themselves. *Id.* at 2445.

In contrast, the Court did not even implicitly decide whether to apply *Davis* to the litigants in that case because Michigan obviated the need for the Court to address the issue. Michigan cited its own tax refund statute and this Court's decision in *Iowa-Des Moines Bank v. Bennett*, 284 U.S. 239 (1931), for the proposition that Davis was entitled to a refund if the tax structure challenged by him was unconstitutional. Brief for Appellee in *Davis*, p. 63. The Court merely recited and accepted Michigan's concession as the basis for its statement that Davis was entitled to a refund to the extent he had paid discriminatory taxes. *Davis*, 489 U.S. at 817. *Stare decisis* is not implicated here; *Davis* is not precedent for awarding a refund to other federal retirees because the Court never determined the refund issue in *Davis*. *See United States v. L.A. Tucker Truck Lines, Inc.*, 344 U.S. 33 (1952); *United States v. Mitchell*, 271 U.S. 9 (1926). Unlike *Bacchus*, *Davis* cannot be "fairly read to hold as a choice of law that its rule should apply retroactively to the litigants then before the Court." *Beam*, 111 S. Ct. at 2445. Instead, *Davis* can only be fairly read to accept Michigan's concession as an invitation not to address the refund issue at all.

Michigan's refund concession also renders irrelevant the fact that *Davis* did not explicitly reserve the question of retroactivity. *See Beam*, 111 S. Ct. at 2445. Under Justice

Souter's analysis in *Beam*, a decision is ordinarily applied to the litigants in the case before the Court and is therefore presumed to apply retroactively. Because of that presumption, a failure to reserve the question of retroactivity normally indicates that the holding of a particular case must be applied retroactively. However, when the Court is not required, even implicitly, to consider whether its holding in the case before it should apply to the litigants in that case as a matter of federal law, the ordinary presumption is abrogated. There was no need to reserve the issue in *Davis* because, with Michigan's concession, the question simply was not part of the case.

The *Beam* principle of equality among litigants does not support a retroactive application of *Davis*. *Beam's* concern was with the inequity of this Court treating similarly-situated litigants dissimilarly, not with the differences that inevitably result from the several states' varying choices of how to follow this Court's interpretation of federal law. The Constitution sets minimum standards that state remedial schemes must obey; it neither forbids nor requires that states go beyond those requirements. *See McKesson*, 496 U.S. at 52 n.36. Michigan's willingness to grant a refund to Davis himself, for whatever reason, is not the equivalent of a principled decision of constitutional law by this Court, and it should not subject numerous other states to devastating liability.[15] To hold otherwise is to promulgate constitutional law by inadvertence or accident. Because

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[15] Since retroactivity was not an issue in *Davis*, other states had no opportunity to point out the crushing blow which its retroactive application would deal them and their citizens. Nor did those other states, which would not have made the concession Michigan did and whose state laws may be very different from Michigan's statutes, have an opportunity at that time to demonstrate to the Court why *Davis* should not be applied retroactively under this Court's own decisions.

retroactivity was neither litigated nor decided by this Court in *Davis*, *Beam* does not require the retroactive application of *Davis*. This Court should apply the rule of *Chevron Oil* and hold that under federal law *Davis* need only be applied prospectively.

III. THE STATES CAN CONSTITUTIONALLY DENY RETROACTIVE RELIEF AS A MATTER OF REMEDIES LAW.

If the *Chevron Oil* test is not applied to give *Davis* prospective-only effect as a choice of law decision, the Court should allow the states to deny retroactive relief as a matter of remedies law.[16] The authority of the states to do so flows rationally from *Beam's* recognition that remedial considerations may cause courts to deny parties the "relief that would have been awarded if the rule had been an old one." 111 S. Ct. at 2443. If a state demonstrates the kind of legitimate reliance interests given effect through the *Chevron Oil* rule, those legitimate reliance interests are "entitled to consideration in determining the nature of the remedy that must be provided, a matter with which *McKesson* did not deal." *Id.* at 2448.[17]

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[16] "[T]he remedial inquiry is one governed by state law, at least where the case originates in state court." *Beam*, 111 S. Ct. at 2443; *see also* ATA, 496 U.S. at 224 (Stevens, J., dissenting).

[17] *McKesson* established certain minimum due process standards governing state tax refund mechanisms for taxpayers who, without any predeprivation remedy available, paid state taxes involuntarily. However, of critical importance to the result reached in *McKesson* was the Court's explicit rejection of Florida's claim that it relied on a "presumptively valid statute" and its observation that Florida could "hardly claim surprise at the . . . invalidation of" the tax scheme in question. 496 U.S. at 46. *See also ATA*, 496 U.S. at 182 (citing *McKesson* for the proposition that reliance interests are of little concern if the state "can easily foresee the invalidation of its tax statutes. . . .") Thus, in cases in which the law-changing decision was not easily foreseeable, equitable considerations in fashioning a remedy should be given much greater -- or even dispositive -- weight.

The concept that reliance interests may be given effect at the remedial stage is not a new one. Indeed, Justice Souter's opinion in *Beam* drew on the concurring opinion of Justice Harlan in *United States v. Estate of Donnelly*, 397 U.S. 286 (1970):

> To the extent that equitable considerations, for example, "reliance," are relevant, I would take this into account in the determination of what relief is appropriate in any given case. There are, of course, circumstances when a change in the law will jeopardize an edifice which was reasonably constructed on the foundation of prevailing legal doctrine.

Id. at 296 (Harlan, J., concurring). "[F]lexibility in the law of remedies," *id.* at 197, permits courts to refuse to award retroactive relief when its consequences are unduly harsh and disturb settled and justifiable expectations.

This Court has not always clearly articulated whether a particular decision was applied prospectively only as a matter of remedies law or otherwise. *E.g.*, *Buckley v. Valeo*, 424 U.S. 1, 142-43 (1976); *Cipriano v. City of Houma*, 395 U.S. 701 (1969). However, it has repeatedly affirmed that some decisions would simply be too disruptive and work too great a hardship on innocent parties to be applied retroactively. Thus, the potentially "devastating" impact on pension funds of retroactive liability led the Court to deny retroactive relief under Title VII of the Civil Rights Act of 1964, 42 U.S.C. § 2000e, when it held that a pension fund's monthly contribution levels unlawfully discriminated on the basis of sex. *Los Angeles Dept. of Water &*

Power v. Manhart, 435 U.S. 702 (1978).[18] In *Lemon II*, the Court cited *Chevron Oil*, but it also treated the prospectivity/retroactivity question as one of equitable remedies. 411 U.S. at 197-200. The Court chose to "look to the practical realities and necessities inescapably involved in reconciling competing interests, notwithstanding that those interests have constitutional roots." *Id.* at 201. Good faith and reliance on a statute, which the state could not be expected to predict would be invalidated, justify prospective application; otherwise, states would have to "stay their hands" until statutes are at some point "ratified" by this Court's decisions or "risk draconian, retrospective decrees," a prospect which "could seriously undermine the initiative of state legislators and executive officials alike." *Id.* at 207-08. There are times when the Court has simply acknowledged that "[t]here is no justification . . . to impose this magnitude of burden retroactively on the public." *Arizona Governing Comm. v. Norris*, 463 U.S. at 1107 (1983). This is such a case.

If *Davis* is to be applied retroactively as a choice of law, then state courts must be able to deny retroactive relief on an equitable basis at the remedial stage in appropriate tax refund cases arising in state courts just as this Court has done in appropriate constitutional and statutory cases arising in federal courts. That is exactly what Virginia has done in this case. Its decision should be affirmed. Extraordinary liability of the magnitude faced by Virginia ($467,000,000.00), North Carolina (at least $140,000,000.00, exclusive of interest), Arizona ($339,000,000.00) and other states should not be imposed on

[18] The *Manhart* decision was reached in the face of a strong Title VII "presumption in favor of retroactive liability [which] can seldom be overcome." 435 U.S. at 719.

unsuspecting states as the result of an unforeseen and unpredictable decision invalidating statutes which had existed virtually unchallenged for up to fifty years. Equity cannot permit federal retiree taxpayers to reap such an unanticipated and unjustifiable windfall at the expense of all the citizens and taxpayers of their respective states.

CONCLUSION

The question before this Court boils down to the propriety of imposing enormous and unforeseen liabilities on the states as a result of *Davis*. Should the citizens and taxpayers in all these states be forced to shoulder additional tax burdens or suffer significant reductions in services because of the states' failure to extend to federal retirees an exemption granted to state and local governmental retirees as a form of employment benefit? Should federal retirees be allowed to recover hundreds of millions of dollars in refunds of taxes they paid year after year after year without challenge? To ask the question is to answer it. The Court should apply *Chevron Oil* to hold that *Davis* is to be applied prospectively only or should allow refunds to be denied as a remedial determination that retroactive relief is not appropriate.

The Court should affirm the decision of the Virginia Supreme Court and the decision of the other state supreme courts denying refunds to federal retirees for pre-*Davis* taxes, which are currently pending before the Court, including the decision of the North Carolina Supreme Court in *Swanson v. North Carolina*.

Respectfully submitted,

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No. 91-794

IN THE
SUPREME COURT OF THE UNITED STATES
OCTOBER TERM, 1992

HENRY HARPER, et al,

Petitioners,

v.

VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

On Writ of Certiorari to the
Supreme Court of Virginia

AMICUS CURIAE BRIEF OF THE CITY OF NEW YORK IN SUPPORT OF RESPONDENT

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No. 91-794

IN THE
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HENRY HARPER, et al,

Petitioners,

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VIRGINIA DEPARTMENT OF TAXATION,

Respondent.

AMICUS CURIAE BRIEF OF CITY OF NEW YORK IN SUPPORT OF RESPONDENT

Interest of the Amicus Curiae

Pursuant to Rule 37.5, the City of New York, as a political subdivision of the State of New York, is exercising the right to file a brief amicus curiae in support of the position of the State of Virginia.

The City's interest in the case stems from the fact that a similar question of liability for a tax refund may arise under the personal income

tax law which the City imposes. That law excludes from the tax the amounts paid as pensions by the State of New York or by its political subdivisions, including the City of New York. [New York City Administrative Code, Title 11, §11-1712(c)(3)(i)]. No such exclusion was provided for pensions paid by the federal government until a statutory amendment was enacted in 1989 to take effect on January 1 of that year. [Id., §11-1712(c)(3)(ii); N.Y. Laws 1989, c.664.]

Summary of Argument

Davis v. Michigan Dept. of Treasury, 489 U.S. 803 (1989), did not decide whether its determination should be applied prospectively or retrospectively. The Court indicated that Mr. Davis was entitled to a refund, but this was based upon a concession that this was the appropriate relief by the State of Michigan when the appellant had also sought such relief. Such concession or agreement is usually accepted by

the Court and, as a result, no attempt is made to decide the issue that would otherwise arise. Here it seems clear that the Court relied on the concession. Nor does James B. Beam Distilling Co. v. Georgia, __U.S.__, 111 Sup. Ct. 2439 (1991), or any of the principles decided in that case determine the issue of Davis retroactivity.

Since 1965 in a variety of cases, both civil and criminal, it has been held that particular determinations made by this Court shall apply only prospectively. In Chevron Oil Co. v. Huson, 404 U.S. 97 (1971), a three-prong test was formulated to apply to civil cases. The Davis case fully satisfies all the prongs of that test.

ARGUMENT

THE DETERMINATION MADE IN DAVIS v. MICHIGAN SHOULD BE APPLIED PROSPECTIVELY WHEN IT IS EXTENDED TO INCOME TAX LAWS OF OTHER STATES AND MUNICIPLALITIES.

a. This Court did not decide whether its decision in the Davis Case should be treated as prospective or retrospective.

The petitioners seek to avoid discussing whether the Davis case should be applied prospectively or retrospectively. They contend that the decision was already made in the determination of that case. They take this position despite the fact that, in Davis, this Court said (489 U.S. at 817):

> The State having conceded that a refund is appropriate in these circumstances, see Brief for Appellee 63, to the extent appellant has paid taxes pursuant to this invalid tax scheme, he is entitled to a refund.

The concession to which the Court referred also accorded with the relief sought by the appellant in the conclusion of his main brief

(p.27) and repeated at page 10 of his reply brief.

Where both parties agree, for example, to the measure of relief to be granted to a successful plaintiff, the courts normally accept their conclusion. The basic governing principle has been well stated in Mitchell v. New York Hospital, 61 NY2d 208 (1984), where the Court said (p. 214):

> Whenever the enforceability of a stipulation among parties in a civil case is put in issue, we must begin our analysis with the recognition that courts have long favored and encouraged the fashioning of stipulations as a means of expediting and simplifying the resolution of disputes. (Salesian Soc. v Village of Ellenville, 41 NY2d 521, 525-526.) We have repeatedly held that, unless public policy is affronted, parties to a civil dispute are free to chart their own litigation course. (T.W. Oil v Consolidated Edison Co., 57 NY2d 574, 579-580; Rector, Church Wardens & Vestrymen of St. Bartholomew's Church v Committee to Preserve St. Bartholomew's Church, 56 NY2d 71, 76; Martin v City of Cohoes, 37 NY2d 162, 165.) They "may fashion the basis upon which a particular controversy will be resolved" (Cullen v Naples, 31 NY2d 818, 820) and in

> doing so "[t]hey may stipulate away statutory, and even constitutional rights." (Matter of New York, Lackawanna & Western R.R. Co., 98 NY 447, 453).

Essentially the same principle has been applied by this Court and lower federal courts. See, e.g., Pacific R.R. v. Ketchum, 101 U.S. 289, 297 (1879); Prout v. Starr, 188 U.S. 537, 542 (1903); Johnson v. United States, 318 U.S. 189 (1943); Muslin v. Frelinghuysen Livestock Managers, 777 F.2d 1230, 1231, n.1 (7th Cir., 1985); Calvin Klein Ltd. v. Trylon Trucking Corp., 892 F.2d 191, 194 (2d Cir., 1989).

Michigan also applies the same stipulation principle. Harris v. Sweetland, 48 Mich. 100, 11 N.W. 830, 831-2 (1882); Kline v. Kline, 92 Mich. App. 62, 284 N.W.2d 488, 492-3, 495-6 (1979). See Dana Corp. v. Appeal Board of Mich. Emp. Sec. Com'n, 371 Mich. 107, 123 N.W.2d 277, 278 (1963).

Courts generally look with favor on such stipulations. 83 C.J.S. Stipulations, §2.

Normally such stipulations must be in writing or made in open court. Where, however, the intent of the parties is made clear, even an implied or informal stipulation will be followed. Cates v. Morgan Portable Bldg. Corp., 780 F.2d 683, 687-8 (7th Cir., 1985); Muslin v. Frelinghuysen Livestock Managers, supra, 777 F.2d at 1231 n.1; International Adm'rs. v. Life Ins. Co., 753 F.2d 1373, 1376 (7th Cir., 1985); Cullen v. Maples, 31 N.Y.2d 818, 820 (1972). See 83 C.J.S. Stipulations §4b (3).

Normally a stipulation may not deal with questions of law. Stipulations with regard to damages, however, are regarded as appropriate. Burstein v. United States, 232 F.2d 19, 23 (8th Cir., 1956); Fisher v. First Stamford Bank and Trust Co., 751 F.2d 519, 523 (2d Cir., 1984); Murphy Door Bed Co. v. Interior Sleep Systems, 874 F.2d 95, 103 (2d Cir., 1989); City of Novi v. City of Detroit, 166 Mich. App. 397, 420 N.W.2d 839, 843

(1988); T.W. Oil v. Con Edison Co., 57 N.Y.2d 574, 579-80, 586-7 (1982).

In Davis, as we have earlier pointed out, the State conceded that a refund was the appropriate relief for the appellant to the extent that he had paid taxes under what this Court found to be an invalid tax scheme. This concession was in accord with relief sought by the appellant. This clear agreement between the parties is essentially the equivalent of a stipulation covering the nature of the relief.

Under the circumstances it seems plain that this Court did not consider whether the relief to be granted for those affected by the invalid tax scheme was to be prospective or retrospective. Certainly there was no discussion of that issue. And the reliance on the concession makes it plain that the issue was not considered, since the concession dealt with all the relief necessary in Davis.

The appellants attempt to escape this by an unusual contrivance. They assert that the concession made by the State of Michigan in Davis could not be considered until this Court first found the tax invalid and then decided to apply that holding to Mr. Davis (App. Br., p.8-9). In substance, they seem to be arguing that this Court need not have relied on the concession, since it had already been decided what relief for invalidity should be granted to Mr. Davis.

The appellants, in addition, rely on James B. Beam Distilling Co. v. Georgia, __U.S.__, 111 Sup. Ct. 2439 (1991), as a basis for concluding that the determination of this Court in Davis decided that it should be applied retroactively. First, they state that an opinion that makes no mention of retroactivity decides that retroactivity shall apply (App. Br., p.10). They rely on the dictum of Justice Souter in Beam at 111 Sup. Ct. at 2445-6, n.2, which is

introduced by: "Though unnecessary to our ruling here ***", indicating that it is mere dictum. Justice Souter's opinion is joined by only one other justice, Justice Stevens. We can find no such clear intimation in Justice White's concurring opinion. The portion quoted by the appellants from Justice White's opinion appears to refer to the decision concerning the Twenty-First Amendment.

Nor is there any such suggestion in the concurring opinions of Justices Blackman and Scalia, each joined by the other and also by Justice Marshall. They concurred in the result in Beam on the basis of their view that all decisions must be applied retroactively and that applying a determination prospectively would go beyond the power of the Court. Their view does not mean that they concluded that a failure to discuss retroactivity or prospectivity, such as occurred in Davis, means that the Court has decided that retroactivity applies.

The basis for the conclusion they reached makes such a decision unnecessary since, by their approach, retroactivity would always automatically govern. Should these three Justices ultimately decide that stare decisis required them to accept prospectivity under some circumstances, they would then be faced, apparently for the first time, with the question of whether a failure to discuss the matter is, in effect, a decision calling for retroactivity.

In any event, it would seem strange that a determination of major consequence could rest on mere silence by the Court. In at least some of these cases, the briefs may not discuss the issue of retroactivity. Consequently, an issue undiscussed in the briefs would be decided by a decision unexpressed in the opinion.

If a presumption that silence in the opinion indicates that the Court has decided that retroactivity shall apply, it would surely not govern where the opinion explicitly indicates

that the issue was not considered either because of a concession or an implied stipulation by the parties. Apparently the petitioners seek to go beyond Justice Souter's determination resting on silence. They would have the Court hold that, even though there is a basis for deciding the case without passing on the issue of retroactivity and even though the Court indicated it was relying on that other ground, it must be concluded that the Court, in some unusual way, considered retroactivity and decided that it applied.

b. **Prospectivity**.

(1)

Until the 1965 decision of Linkletter v. Walker, 381 U.S. 618, almost any decision overruling a prior decision or reaching a new or novel result, criminal or civil, constitutional or not, would be treated as retrospective. Up to that time, the Supreme Court, and most state courts, followed what has been termed the

Blackstonian theory of law to the effect that a court, in overruling an earlier decision, did not make a new law. Rather, it merely expounded or vindicated the old one from a prior misrepresentation. It treated the old decision, not as bad law, but as simply not being the law. The new decision was an application of what had always been the true law. Linkletter, 381 U.S. at 622-5; Note, Prospective or Retroactive Operation of Overruling Decision, 10 ALR 3rd 1382; Cardozo, The Nature of the Judicial Process (1921), pp. 124-125.

Despite the general rule applied theretofore, the Court in Linkletter relied, in part, on a variety of cases to reach the conclusion that the Court was not required to treat each such determination as retroactive, but rather that it would determine the question of retroactivity by weighing the merits. Linkletter, 381 U.S. at 628-9; Robinson v. Neil, 409 U.S. 505, 507 (1973). In Linkletter,

the Court also indicated that no distinction need be drawn between civil and criminal cases. Linkletter, 381 U.S. at 627-8.

After this shift in the approach to the issue of retroactivity, many criminal cases involving constitutional issues were, until 1987, held to apply prospectively. See, e.g., Stovall v. Denno, 388 U.S. 293, 296-297 (1967); Adams v. Illinois, 405 U.S. 278, 284 (1972); Allen v. Hardy, 478 U.S. 255, 258 (1986). (In Griffith v. Kentucky, 479 U.S. 314, 328 [1987], it was held that new rules governing criminal procedure would apply retroactively to all cases pending on direct review or not yet final.)

Prospectivity was applied also to a number of civil cases. See, e.g., Cipriano v. City of Houma, 395 U.S. 701 (1969); Northern Pipeline Co. v. Marathon Pipe Line Co., 458 U.S. 50, 87-88 (1982); Florida v. Long, 487 U.S. 223, 235, 240 (1988).

A three-prong test was devised in Stovall v. Denno, supra, 388 U.S. at 297, for determining whether the decision in a criminal case should be treated as retroactive. A slightly different three-prong test was established shortly thereafter for civil cases. Chevron Oil Co. v. Huson, 404 U.S. 97, 106-107 (1971).

In criminal cases the three-prong rule was later modified or expanded. It was first held that a decision announcing a new standard is almost automatically nonretroactive. United States v. Johnson, 457 U.S. 537, 549-550 (1982); Solem v. Stumes, 465 U.S. 638, 645-646 (1984); Allen v. Hardy, supra, 478 U.S. at 258. However, Griffith v. Kentucky, supra, 479 U.S. 314, concluded that new rules governing criminal matters would apply retroactively to all cases pending on direct review. But recent cases make it clear that the

new rule will not be applied when a conviction is challenged in a collateral attack. Teague v. Lane, 489 U.S. 288 (1989); Butler v. McKellar, 497 U.S. 407 (1990).

The three-prong test used in civil cases emphasizes the break with the past as its first prong. The three factors to be considered in determining whether retroactivity shall apply in civil matters are stated in Chevron Oil Co. v. Huson, supra, 404 U.S. at 106-107:

> In our cases dealing with the nonretroactivity question, we have generally considered three separate factors. First, the decision to be applied nonretroactively must establish a new principle of law, either by overruling clear past precedent on which litigants may have relied, see, e.g., Hanover Shoe v. United Shoe Machinery Corp, supra, [392 U.S.] at 496, or by deciding an issue of first impression whose resolution was not clearly foreshadowed, see, e.g., Allen v. State Board of Elections, supra, [393 U.S.] at 572. Second, it has been stressed that "we must . . . weigh the merits and demerits in each case by looking to the prior history of the rule in question, its purpose and effect, and whether retrospective operation will further or retard the operation." Linkletter v. Walker,

> supra, [381 U.S.] at 629. Finally, we have weighed the inequity imposed by retroactive application, for "[w]here a decision of this Court could produce substantial inequitable results if applied retroactively, there is ample basis in our cases for avoiding the 'injustice or hardship' by a holding of nonretroactivity." Cipriano v. City of Houma, supra, [395 U.S.] at 706.

This three-factor test has been applied regularly since the Chevron case was decided in 1971. See, e.g.: Northern Pipeline Co. v. Marathon Pipe Line Co., supra, 458 U.S. at 87-88; Saint Francis College v. Al-Khazraji, 481 U.S. 604, 608-9 (1987); Goodman v. Lukens Steel Co., 482 U.S. 656, 662-3 (1987); American Trucking Association, Inc. v. Smith, 496 U.S. 167 110 Sup. Ct. 2323, 2331 (1990); cf., Florida v. Long, 487 U.S. 223, 230 et seq. (1988).

Although Davis did not involve the overruling of a clear past precedent, it did decide an issue of first impression whose resolution was not clearly foreshadowed.

A finding that the first prong of the Chevron test has not been met should not rest on the emphatic language used in the Davis majority opinion. The Court there said that the "plain language of the statute" dictates the result reached and that it had "no difficulty" in reaching that conclusion (489 U.S. at 808). The meaning of the statute was found to be "unmistakable" (id. at 810). Similar forceful language might also be used in an opinion overruling a prior determination of this Court. For example, it is not unusual to say that the determination being set aside rested on no sound legal basis. Moreover, while eight justices joined in the Davis opinion, one member of this Court dissented.

Here the issue decided was plainly of "first impression" and its "resolution was not clearly foreshadowed." This is shown by the history of state and local tax exemptions for pension income of their own former employees.

The federal statute, 4 U.S.C. §111, was enacted in 1939. As early as 1920, New York State had enacted a tax exemption for pensions of State and local employees (N.Y.Laws 1920, c.741, §70). That year a similar tax exemption provision was also enacted for New York City (N.Y.Laws 1920, c.427, §1, amending Greater New York City Charter §1723). These provisions have continued until the present. An amendment to the New York Constitution, adopted in 1938 and effective on January 1, 1939, provided for exemption from taxation for employees of the State and its subdivisions (Const. Art. 5, §7, Art. 16, §5).

New York State had an income tax for many years before 1939 (N.Y. Tax Law, Art. 16, now in Art. 22). New York City's personal income tax took effect in 1966 (N.Y.C. Admin. Code, Title T, now in Admin. Code, Title 11, ch.17).

At least one other State had exempted pensions of its former employees from its own income tax before 4 U.S.C. 111 was enacted. Mont. Laws 1937, c.87, §13. A number of other States enacted similar exemptions within a few years after 1939. E.g., 1941 N.C. Sess. L., c.25 §9; Ch 325, 1942, Va. Acts 500; 1945, S.C. Code of Laws §9-1-1680.

In the course of time, other states adopted similar tax provisions so that, when the Davis case reached the courts, there were 23 states, in addition to Michigan, providing such an exemption. See, Harper v. Virginia Dept. of Taxation, 241 Va. 232, 401 S.E.2d 868, 871, n.3 (1991); Federal Tax Administrators, Research Report No. 131, entitled Davis v. Michigan Department of Treasury: One Year Later.

Thus we have two states adopting legislation before the federal enactment in 1939 and numerous other states adopting similar

legislation over the years since then. All granted exemption on pension income of former state or local employees without providing a similar exemption to pensions of former federal employees. Yet, so far as we have been able to find, no case was brought in the courts challenging the state and local employee exemptions until the Davis case was begun in 1984, a lapse of 45 years from enactment of the federal law to the challenge.*

It is difficult to conclude that Davis was foreshadowed when at least 24 state legislatures enacted new, or continued prior, statutes, if the indications were evident that the legislation was doomed to fail upon challenge. It is even more difficult to believe that, if that were so,

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* The case of Streight v. Ragland, 280 Ark. 206, 655 S.W.2d 459 (1983), decided only a year before Davis commenced, unsuccessfully challenged such a statute on behalf of private pensioners, relying on equal protection grounds.

no federal pensioner thought it worthwhile to challenge the state tax on his pension in any of those states.

Aside from the legal issues raised by Justice Stevens in his dissent, this history of the numerous Davis type statutes should, we submit, be enough to meet the first prong of Chevron.

The second Chevron prong involves the consideration of the prior history of the rule, its purpose and effect, and whether retrospective operation will further or retard these considerations. In light of Davis, we must assume that a state's tax on pensions was to be treated the same as one on wages with regard to the limitations of 4 U.S.C. 111. That, however, apparently was not the view of the federal pensioners until the Davis decision. From all appearances they did not assert such a right until after this Court's determination. To give them retrospective benefit would be to give

them refunds which they neither expected nor made claim for until Davis was instituted.

Moreover, in Virginia the Davis type of relief has now been granted by legislation enacted in 1989, taking effect for taxable year 1989. In New York, a new law grants full tax exemptions to federal pensioners under both state and local income taxes for taxable years beginning on or after January 1, 1989 (N.Y.Laws 1989, ch.664).

There would appear to be no ground for treating the second prong as calling for retrospectivity except to provide an unexpected windfall to federal pensioners.

The third prong of Chevron weighs the inequity of the imposition of a retroactive application. As noted, there would be no inequity to federal pensioners because all that retroactivity would give them would be an unanticipated refund. Judicial notice, however, may be taken of the dire fiscal straits of states

and cities. A study by the Federation of Tax Administrators concludes that retroactive refund claims could exceed $2 billion (Research Report No. 131, April 1990, p.8, Table 3, p.18). The impact of retroactivity would be substantial for many, if not most, of them.

While in New York there are two factors that would somewhat reduce the impact of a determination that Davis applies retroactively as compared with the impact upon Virginia, the impact upon New York will nevertheless be substantial. First, the State and the City of New York have, since 1981, provided an exemption of up to $20,000 on all pensions of persons 59½ or older, whether the pension is private or public [N.Y. Tax Law, §612 (c) (3-a); N.Y.C. Admin. Code, §11-1712(c) (3-a)].

Second, in New York there are limitations on the recovery of refunds that may not be applicable in other states. Recovery may be

had, as in most other states, pursuant to the administrative tax procedure. In New York an application for such a refund must be made within three years after the tax return was filed or two years from the time the tax was paid [N.Y. Tax Law, §687(a); N.Y.C. Admin. Code, §11-1787(a)]. Recovery may also be had in an action for money had and received with six year period of limitations, but such a recovery is available only when the tax payment was made under protest or was compelled by duress. Mercury Machine Imp. Corp. v. City of New York. 3 N.Y.2d 418 (1957); Rochester v. Chiarella, 58 N.Y.2d 316, 323 91983); Mtr. of Fiduciary Trust Co. v. State Tax Comm., 120 A.D.2d 848, 850 (3rd Dept., 1986).

Although Griffith v. Kentucky supra, has shifted the rule with respect to criminal matters on direct review so that any new determination will be applied retroactively, this provides no reason to abandon the Chevron approach to

civil cases. A failure to apply retroactivity in a criminal case leaves a man in prison. There is no such drastic impact in civil cases. Often, as in the present case, making the Davis case retroactive would merely provide windfalls for persons who had no reason to believe that a portion of their taxes would be refunded.

CONCLUSION

THE JUDGMENT BELOW SHOULD BE AFFIRMED.

Respectfully submitted,

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